85-1219

Supreme Court, U.S.
FILED
JAN 21 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. .....

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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January 21, 1986

QUESTIONS PRESENTED

1. Did the Federal Energy Regulatory Commission ("Commission") exceed its authority in Order No. 380 when, in order to increase competition among pipelines, it abrogated, on a generic basis pursuant to informal rulemaking proceedings, long standing purchase provisions in contracts between interstate pipelines and their customers which it had previously reviewed and approved under Section 7 of the Natural Gas Act ("Act")?

2. Do the informal comment procedures under Section 4 of the Administrative Procedure Act satisfy the hearing and substantial evidence requirements of the Act and meet the due process requirements of the Fifth Amendment under circumstances in which the Commission is considering the abrogation of contracts and the alteration of certificated service?

3. Did the Commission exceed its authority in Order No. 380 in invalidating and proscribing all contract and tariff provisions which caused or required the pipelines' distributor customers to purchase specified volumes of gas on the ground that such provisions prevented such customers from "shopping around" and were therefore *per se* "anti-competitive" and "unjust and unreasonable"?

4. Did the Commission act arbitrarily in failing to address purchase obligations in the pipelines' contracts with their producer/suppliers after having invalidated purchase obligations in their contracts with their distributor customers?

5. Does the Commission have authority under Section 5 of the Act, whether through informal rulemaking proceedings or otherwise, to revoke or substantially modify certificates of public convenience and necessity issued under Section 7 of the Act?

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PARTIES TO THE PROCEEDING BELOW

Algonquin Gas Transmission Company
Aluminum Association, The
ANR Pipeline Company
Arkansas Louisiana Gas Company
Brooklyn Union Gas Company, The
Cascade Natural Gas Corporation
Chattanooga Gas Company
City Gas Company
Colorado Interstate Gas Company
Columbia Gas Transmission Corporation
Consolidated Gas Supply Corporation
Consolidated Gas Transmission Corporation
Consumers Power Company
El Paso Natural Gas Company
Equitable Gas Company
Foothills Pipe Lines (Yukon), Ltd.
Georgia Industrial Gas Group, The
Great Lakes Gas Transmission Company
Illinois Gas Company
Inter-City Gas Corporation
Kansas State Corporation
Madison Gas and Electric Company
Michigan Consolidated Gas Company
Michigan Gas Utilities Company
Michigan Public Service Commission, The
Midwestern Gas Transmission Company
MIGC, Inc.
Natural Gas Pipeline Company of America
Northern Illinois Gas Company
Northwest Energy Company on behalf of Northwest Pipeline Corporation and Northwest Central Pipeline Corporation
Northwest Natural Gas Company
Pacific Gas and Electric Company
Pacific Interstate Companies
Pacific Interstate Offshore Company
Pacific Lighting Gas Supply Company
Pacific Offshore Pipeline Company
Pan-Alberta Gas Ltd.
Panhandle Eastern Pipe Line Company

People of the State of California, The
Peoples Gas Light and Coke Company, The
Process Gas Consumers Group, The
Public Service Commission of the State of New York .
Public Service Commission of Wisconsin, The
Public Service Electric and Gas Company
Public Utilities Commission of the State of California
Southern California Gas Company
State of Michigan, The
Tennessee Gas Pipeline Company, a Division of Tenneco, Inc.
Texas Eastern Transmission Corporation
Texas Gas Transmission Corporation
TransCanada Pipelines Ltd.
Transcontinental Gas Pipe Line Corporation
Transwestern Pipeline Company
Trunkline Gas Company
Washington Gas Light Company
Washington Natural Gas Company
Wisconsin Fuel and Light Company
Wisconsin Gas Company
Wisconsin Gas and Electric Company
Wisconsin Natural Gas Company
Wisconsin Power and Light Company
Wisconsin Public Service Corporation

LIST OF SUBSIDIARIES AND AFFILIATES PURSUANT TO RULE 28.1

Belco Petroleum Corporation
- Belco Development Corporation
- Belco Petroleum Australia, Inc.
- Belco Petroleum Corporation of Peru
- Belco Petroleum Ecuador, Inc.
- Belco Petroleum International, Ltd.
- Belco Petroleum Latin America, S.A.
- Belco Petroleum North America, Inc.
- Belco Petroleum of Israel, Ltd.
- Belco Wyoming Corporation
- Belcoal, Inc.
- BelNorth Petroleum Corporation
- BelNorth Energy Corporation
- I N Holdings, Inc.
  - Andex Oil Co. Ltd.
- Pelican Exploration, Ltd.
- Sonneborn Associates Petroleum Corporation

Cogeneration Resources Company

HNG InterNorth Gas Marketing, Inc.

HNG InterNorth, Inc.

Houston Natural Gas Corporation
- The Bermuda Company
- Black Marlin Pipeline Company
- Coal Properties Corporation
- Co-Gen Fuels Company
  - HNG Bayou Co-Gen, Inc.
  - HNG Mojave, Inc.
- Comanche Marketing, Inc.
- Continental Group Resources Company
- Cora Dock Corporation
- Florida Gas Transmission Company
- Florida Hydrocarbons Company
- Florida Intrastate Pipeline Company
- Gulf Company Ltd.
- HNG Capital Corp.
- HNG Clearing House Company
- HNG Cortez Pipeline Company
- HNG Gas Liquids, Inc.

HNG Industrial Natural Gas Company
HNG InterNorth Operating Company
HNG Interstate Pipeline Company
HNG Offshore Company
HNG Oil Company
- FEC Offshore Inventory Co.
- Florida Exploration Company
- HNG Exploration Company
- HNG Fossil Fuels Company
- HNG Oil (Sumatra) Inc.
- Ocelot Oil Company
- Southeastern Exploration Company

HNG Resources, Inc.
HNG Texoma Gas Company
HPI Transmission, Inc.
Houston Pipe Line Company
InterNorth, Inc.
Intratex Gas Company
Llano, Inc.
Llano CO_2, Inc.
Marcoal Inc.
Marine Industries Inc.
Minerals Inc.
Natural Gas Marketing & Storage Company
NMesco Fuels, Inc.
Pacific Atlantic Marketing, Inc.
Panhandle Gas Company
Pott Industries Inc.
- Caruthersville Shipyard Inc.
- The Dixie Dredge Export Corporation
- Paducah Marine Ways Incorporated
- River Equipment Co.

Riverside Farms Company
Sunniland Pipe Line Company, Inc.
Transgulf Pipeline Company
Transgulf Terminal & Storage Company
Transwestern Pipeline Company
Valley Pipe Lines, Inc.

Hydrocarbon Transportation, Inc.
InterNorth International Incorporated
    Consolidated Gathering Systems Limited
        Consolidated Natural Gas Limited
    Consolidated Pipe Lines Company
    Consolidex Gas and Oil Limited
    InterNorth International Oil, Inc.
    Northern Liquid Fuels International Ltd.
        InterNorth Petrochemical Division
        N.L.F.I. International (U.K.) Ltd.
        N.L.F.I. Products and Crude, Inc.
    The Protane Corporation
Norchem, Inc.
    Norval Polymers Company
Northern Arctic Gas Company
Northern Coal Company
Northern Coal Pipeline Company
Northern Cogeneration One Company
Northern Cogeneration Two Company
Northern Cogeneration Three Company
Northern Cogeneration Four Company
Northern Cogeneration Five Company
Northern Engineering International Co.
Northern Gas Gathering, Inc.
Northern Gas Products Company
    Florida Hydrocarbons Company
    HNG Gas Liquids, Inc.
    HPI Transmission, Inc.
    NGP Pipeline Company
Northern Helex Company
Northern Intrastate Pipeline Company
Northern Minerals Company
Northern Natural Resources, Inc.
Northern Oil Interstate Pipeline Company
Northern Overthrust Pipeline Company
Northern Plains Natural Gas Company
AmNorth, Inc.
    Northern Border Pipeline Company
Northern Texas Intrastate Pipeline Company
Northern Trailblazer Pipeline Company
    Pathfinder Assurance Limited

UPG, Inc.
- Falcoal, Inc.
- J.E. Fowler Petroleum Products, Inc.
- J.T. Richardson Rig & Construction, Inc.
- Port Cordova, Inc.
- UPG Falco Division of UPG, Inc.
- Webster Transportation Company, Inc.

West Texas Carrier Corporation

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v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Transwestern Pipeline Company ("Transwestern") seeks review of a decision of the United States Court of Appeals for the District of Columbia Circuit upholding a series of orders of the Federal Energy Regulatory Commission ("FERC" or "Commission") that declared unlawful "minimum bill" and "minimum take" provisions in Transwestern's contracts and tariffs and those of other interstate natural gas pipeline companies subject to the jurisdiction of the Commission under the Natural Gas Act (the "Act").[1]

OPINIONS BELOW

The opinion of the court of appeals is reported at 770 F.2d 1144 and is reproduced in the Appendix to this Petition. The orders of the FERC are reported at III Fed. Energy Guidelines

[1] Such orders, which were issued in FERC Docket No. RM83-71, are identified as Order Nos. 380, 380-A, 380-B, 380-C and 380-D. These orders are referred to in this petition as "Order No. 380."

(CCH) ¶¶ 30,571, 30,584, 30,607 (1984), and are likewise reproduced in the Appendix.

JURISDICTION

The judgment of the court of appeals was entered on August 20, 1985. App at 57. Rehearing was denied on October 25, 1985. App at 69. The jurisdiction of this Court is invoked under 28 U.S.C. §§ 1254(1), 2350 (1982).

STATUTES INVOLVED

The principal statutory provisions involved are Sections 5(a), 7(b), (c), (e), and 19(b) of the Natural Gas Act of 1938, 15 U.S.C. §§ 717d(a), 717f(b), (c), (e), 717r(b) (1982), Sections 4, 5, 7 and 8 of the Administrative Procedure Act, 5 U.S.C. §§ 553-554, 556-557 (1982), and Section 403 of the Department of Energy Organization Act, 42 U.S.C. 7173(c) (1982), all of which are printed in the Appendix.[2]

STATEMENT OF THE CASE

This case involves the validity of Order No. 380. There, in order "to promote price competition among pipelines" (see App 34.), the Commission abrogated provisions in contracts and tariffs which required or otherwise caused the customers of interstate pipelines to purchase agreed minimum volumes of gas. It did so on a generic basis pursuant to informal rulemaking proceedings.

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[2] Parallel construction is given comparable sections of the Natural Gas Act and the Federal Power Act. *See FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 350-51 (1956); *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 (1981). Sections 206 and 313 of the Federal Power Act, 16 U.S.C. §§824e, 8251 (1982), are comparable to Sections 5 and 19 of the Natural Gas Act and thus are also implicated. See App. at 293.

Transwestern is a natural gas company regulated by the Commission under the Natural Gas Act. It purchases natural gas produced in Texas, Oklahoma and New Mexico for resale and delivery to its two principal customers, Pacific Lighting Gas Supply Company ("PLGS") and Northwest Central Pipeline Corporation ("NWC"). These customers account for more than 99 percent of Transwestern's total system-wide sales. PLGS redelivers gas purchased from Transwestern to its affiliate, Southern California Gas Company ("SoCal"), for resale and distribution in the Southern California area. NWC supplies markets in the mid-west.

Both SoCal and NWC have suppliers in addition to Transwestern. SoCal receives gas from three affiliated interstate pipelines, two of which deliver gas from the offshore federal domain, while the third delivers gas produced in Canada. SoCal also purchases from another interstate pipeline, El Paso Natural Gas Company, as well as from producers in California. NWC also receives supplies from other interstate pipelines but purchases the majority of its gas supplies directly from producers in Kansas, Oklahoma, Colorado and Wyoming.

Since 1959, when Transwestern was originally certificated to begin service, it has sold gas to PLGS pursuant to privately negotiated contracts which contained minimum bill provisions requiring PLGS to take or pay for certain minimum volumes of gas on a yearly basis and minimum take provisions requiring PLGS to purchase a certain minimum quantity of gas on a daily basis. *See Transwestern Pipeline Co.*, 22 FPC 391, *modified*, 22 FPC 542 (1959).

The contract currently in effect with PLGS was entered into in 1967. It is scheduled to expire in 1991. Under such contract, Transwestern agreed to sell and PLGS agreed to purchase a contract demand or CDQ volume of 750,000 Mcf of gas per day at rates to be approved or determined by the Commission. PLGS agreed to take or pay for 91 percent of the 750,000 Mcf per day

CDQ volume on an annual basis. A five-year "make-up" was provided for gas paid for but not taken. The contract also provided that PLGS would purchase from Transwestern at least 600,000 Mcf of gas per day. This is known as the minimum daily take or MDTQ volume.

The contract and all of its terms were reviewed under Section 7 of the Natural Gas Act, and a certificate of public convenience and necessity was issued by the Commission authorizing Transwestern to make the sales and render the service provided for therein. *Transwestern Pipeline Co.*, 41 FPC 134 (1969).

Transwestern is also authorized to sell a total of 250,000 Mcf of gas per day to NWC. These authorizations, like the authorization to sell to PLGS, were predicated on privately negotiated contracts with NWC, then Cities Service Gas Company, in 1963 and 1967, respectively. Each of such contracts were reviewed and approved by the Commission in contested proceedings under Section 7 of the Act. *Transwestern Pipeline Co.*, 34 FPC 659 (1965); *Transwestern Pipeline Co.*, 43 FPC 322 (1970).[3] Like the PLGS contracts, the contracts with NWC contain a provision called the "minimum purchase obligation", requiring NWC to take or pay for 90 percent of the CDQ on an annual basis with a similar provision for make-up of gas paid for but not taken.[4] Unlike the PLGS arrangement, however, NWC did not commit to take any minimum daily volume.

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[3] As Transwestern was certificated for service to highly competitive markets, virtually all of its contracts, including those abrogated by Order No. 380, were the subject of extensive, contested certificate proceedings. *See e.g. Pacific Gas Transmission Co.*, 40 FPC 1147 (1968), *modified*, 41 FPC 251 (1969); *Transwestern Pipeline Co.*, 36 FPC 176 (1966), affd. *sub nom. Southern California Edison Co.* v. *FPC*, 387 F2 619 (3rd Cir. 1967) cert. denied, 392 US 909 (1968).

[4] Transwestern's base contracts with NWC and its 1967 contract with PLGS are set forth in a separate appendix to this petition.

As required by the Commission's regulations, Transwestern's contracts were restated in tariff and service agreement form. 18 C.F.R. § 154.1, *et seq.* (1985).

To render service to PLGS and NWC, Transwestern purchases gas under more than 1200 contracts with producers. Virtually all of these contracts require Transwestern to "take or pay for" specified quantities of gas on an annual basis, as well as to take minimum volumes of gas on a monthly basis.

Under the Natural Gas Act, Transwestern and other natural gas companies are required to apply for and receive certificates of public convenience and necessity under Section 7 of the Act before they can make the sales or commence the service agreed to in the contracts with their customers. 15 U.S.C. § 717f (1982). The contractual arrangements underlying these certificates establish the type of service which the pipeline proposes and is authorized to perform. In the case of PLGS, Transwestern had an assured market for 600,000 Mcf of gas per day. It was also assured that PLGS would pay for 91 percent of 750,000 Mcf per day. It thus sought and received authorization to provide a high loadfactor, baseload service to PLGS. Similarly, but not with the same level of market assurance, the sales and service which Transwestern proposed for NWC involved assurance that NWC would take or pay for 90 percent of the volume of gas Transwestern was committed to sell and deliver.

In accordance with Commission practice, Transwestern's charges to PLGS and NWC are in the form of a two-part rate consisting of a demand charge based on the maximum contract and certificated levels for each customer and commodity charges which include the cost of gas purchased by Transwestern for resale.

Orders No. 380 and 380-A eliminated gas costs from the commodity rates. App. at 123-24. The Commission concluded that the presence of such costs would have the effect of restraining a customer from purchasing cheaper gas than that available from

a pipeline with whom it had a contract containing a minimum bill provision. Because of this possibility, the Commission concluded that minimum bills were anti-competitive. App. at 85-88. The Commission also reasoned that the take-or-pay aspects of the commodity bill had the potential for permitting the recovery of costs which the pipeline might not have incurred and that such provisions were therefore unjust and unreasonable. App. at 82-85.

After further comments, the Commission in Order No. 380-C found that minimum take provisions in contracts, while not involving the potential for the recovery of costs not actually incurred, were likewise anti-competitive and unlawful. App. at 234. The Commission reasoned that such provisions *"cause customers to take gas they would not otherwise take,* thus resulting in charges to customers in excess of the lowest reasonable cost" and that "like minimum commodity bills, [minimum take provisions] *act as a restraint on competition* because the pipelines and the producers remain artificially insulated from market risk." App. at 234, emphasis added.

The proceedings which led to Order No. 380 were informal rulemaking proceedings under Section 4 of the Administrative Procedure Act, 5 U.S.C.A. § 553 (1982). No evidentiary hearings were held. No formal testimony was received. No cross-examination was permitted. Requests for oral argument were denied. The findings which led to the order were based on unsworn comments and claims made by interested parties. The Commission did not in Order No. 380 make any specific findings with respect to the facts regarding any particular pipeline contract or tariff. Gas costs were excluded from commodity rates, and minimum take provisions were generically invalidated simply on the ground that they were anti-competitive. App. at 85-88.

Transwestern appealed the Commission's orders to the Court of Appeals for the District of Columbia Circuit. *Wisconsin Gas*

Co., et al. v. *FERC*, Nos. 84-1358 *et al.* (appeal filed July 30, 1984). Transwestern's principal contentions were those raised here. With the exception of one matter not urged by Transwestern, the court below affirmed the Commission. It agreed with the Commission's rationale that contractual provisions which prevent customers "from shopping for low-cost gas" were anti-competitive and thus unlawful. App. at 36. Its treatment of the matter of contract abrogation was relegated to a brief statement in a footnote:

> Petitioners also contend that the Order unlawfully alters the terms of existing contracts by destroying the mutuality of obligations between the pipeline and the partial requirements customer. This claim is frivolous. Fixed costs are still recoverable from partial requirements customers through the demand charges and through the fixed cost portions of the minimum bill. At any rate, section 5 gives the Commission authority to alter terms of any existing contract found to be "unjust" or "unreasonable." 15 U.S.C. § 717d(a). *See also Permian Basin Area Rate Cases*, 390 U.S. 747, 783-84 (1968) (rejecting gas producers' argument that Commission action might destroy the contracts in which unjust price escalator clauses were found, holding that "the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests").[5]

App. at 25-26, n.9.

The court of appeals also upheld the adequacy of the Commission's procedures, stating that nothing more was required of the Commission than the minimum procedures specified for informal rulemakings in the Administrative Procedure Act. App. at 55.

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[5] The court's statement with respect to fixed-cost recovery is correct in theory only. As the court noted, substantial fixed costs are included in the commodity portion of a pipeline's rate. App. at 18. Consequently, unless the pipeline sells at or above volume levels utilized in determining rates, it will not recover all of its fixed costs, including its allowed return on equity. *See* App. at 173-74.

As the result of Order No. 380, Transwestern has no assurance, despite its contracts, that any of the gas for which it has contracted with producers and for which it has constructed a pipeline to deliver will be purchased. It nonetheless remains obligated to deliver full contract volumes to PLGS and NWC whenever called upon to do so.[6]

REASONS FOR GRANTING THE WRIT

1. The Decision of the Court of Appeals Is in Conflict with Principles Enunciated in the Decisions of This Court Concerning the Role of Contracts under the Natural Gas Act and the Proof Required for Their Abrogation.

The significant role of contracts under the Natural Gas Act was first before this Court in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956).[7] The Court there stated:

> [O]nly a relatively few wholesale transactions are regulated by the Natural Gas Act and these typically require substantial investment in capacity and facilities for the service of a particular distributor. Recognizing the need these circumstances create for individualized arrangements between natural gas companies and distributors, the Natural Gas Act permits the relations between the parties to be established initially by contract, the protection of the public

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[6] The impact of Order No. 380 on Transwestern is particularly severe and anomalous. Such order exempts high-cost Canadian supplies purchased by SoCal. App. at 201-03. It also exempts high-cost gas purchased from producers by NWC. App. at 152-54. Thus, with respect to both PLGS and NWC, Transwestern is squeezed between lower-cost gas supplies available to those customers and such customers', or their affiliates', obligations, which are not affected by Order No. 380, to purchase higher-cost gas from other suppliers. The effect of the minimum bill and minimum take provisions in Transwestern's contracts had been to protect it against these contingencies.

[7] *See also FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956) (dealing with the role and effect of contracts under the Federal Power Act).

> interest being afforded by supervision of the individual contracts, which to that end must be filed with the Commission and made public.

Id. at 339. The Court also stated:

> By preserving the integrity of contracts, [the Act] permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry.

Id. at 344. The Court made clear, however, that such contracts remain "fully subject" to the authority of the Commission to modify them "when necessary in the public interest," concluding that

> [t]he Act thus affords a reasonable accommodation between the conflicting interests of contract stability on the one hand and public regulation on the other.

Id. at 344.

In *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 154 (1960), this Court, citing *Mobile* stated clearly:

> [T]he scheme of the [Natural Gas] Act was one which built the regulatory system on a foundation of private contracts.

This Court went on to say that *Mobile* "underwrote" the integrity of private contracts under the Natural Gas Act. *Id.* at 154.

In *The Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968), this Court again reiterated the importance of private contracts under the regulatory scheme of the Act and the Commission's limited authority to modify them:

> The regulatory system created by the [Natural Gas] Act is premised on contractual agreements voluntarily devised by the regulated companies; it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity. *See United Gas Co.* v. *Mobile Gas Corp.*, 350 U.S. 332.

See also Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571, 582 (1981) (Commission lacks authority, "absent extraordinary circumstances," to abrogate existing contractual arrangements);

City of Oglesby v. *FERC*, 610 F.2d 897, 903 (D.C. Cir. 1980); *Richmond Power & Light Co.* v. *FPC*, 481 F.2d 490, 496-97 (D.C. Cir.), *cert. denied*, 414 U.S. 1068 (1973); *Sam Rayburn Dam Electric Cooperative* v. *FPC*, 515 F.2d 998, 1002 (D.C. Cir. 1975), *cert. denied*, 426 U.S. 907 (1976); *Town of Alexandria* v. *FPC*, 555 F.2d 1020, 1030 n.55 (D.C. Cir. 1977). As expressed by the court of appeals in the context of parallel provisions of the Federal Power Act,

> [t]he terms of the contract determine the parties' obligations; their agreement should be modified by the Commission . . . *only if imperatively demanded by the public interest.*

Metropolitan Edison Co. v. *FERC*, 595 F.2d 851, 856 n.29 (D.C. Cir. 1979) (emphasis supplied).

The significant role of privately negotiated contracts between pipelines and their distributor customers is thus a firmly entrenched concept in the jurisprudence of the Natural Gas Act.

The court below erred in accepting the Commission's premise that, notwithstanding prior review and approval, any contract provision which inhibits the ability of a pipeline's customer to purchase lower-cost gas is anti-competitive and unlawful *per se*. If enforceable commitments to purchase cannot be enforced, a distributor customer's ability to enter into stable supply arrangements is severely prejudiced. There is, as a practical matter, no reason for a pipeline seller to enter into a firm commitment to sell and to install the facilities necessary for such sale, without a corresponding obligation on the part of its potential customer to purchase sufficient volumes of gas to justify the enterprise.

In *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 388 (1959), this Court observed that it was the intention of Congress that natural gas be sold in interstate commerce at the lowest reasonable rate "consistent with the maintenance of adequate service and the public interest." The Commission in

Order No. 380 focuses solely on current supply and price conditions, disregarding the congressional mandate that the maintenance of adequate service be also considered.

Further, as *Mobile* correctly noted and anticipated, vast amounts have been invested in facilities in reliance on purchase commitments contained in contracts between pipeline suppliers and their distributor customers. Order No. 380 does not address any specific contract in the context of its actual operation. No finding is made that any particular contract in such context is "unjust or unreasonable" or otherwise contrary to the public interest. The Commission's authority to limit the pipeline's ability to enter into enforceable contracts assuring the purchase of specific volumes of gas, as well as its authority to abrogate contracts without specifically addressing such arrangements, are matters which directly and substantially affect both existing and future sales arrangements between pipelines and distributors.

The substantial impact of Order No. 380 on the natural gas industry is acknowledged by the Commission:

> [T]o the extent that the rule may shift certain risks, alter approaches to planning, and allow for more competition in the industry, the *Commission agrees with the commenters who observed that the rule will "restructure" traditional ways of conducting pipeline business.*

App. at 94 (emphasis added).[8]

The importance of these matters in the administration of the Act, together with the total impact of Order No. 380 and the error of the court below in affirming it, warrant review by this Court.

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[8] The Commission justifies its action on the ground that restructuring was the "inevitable outgrowth" of wellhead deregulation under the Natural Gas Policy Act of 1978. 15 U.S.C § 3301 et seq (1985) App. 94. The NGPA did not, however, abrogate the purchase provisions in the pipelines' contracts with their customers.

2. This Court Should Review to Determine Whether the Procedures Followed by the Commission Were Sufficient to Satisfy the Hearing Requirements of Section 5 of the Act, the Substantial Evidence Requirements of Section 19 of the Act, and Otherwise to Satisfy the Requirements of Due Process.

Section 5 of the Act authorizes the Commission, "after a hearing," to determine that a contract is unjust or unreasonable and thus unlawful. *Cf.* 15 U.S.C. § 717d (1982). Whether the hearing requirements of Section 5 are satisfied through informal rulemaking under circumstances in which the Commission is undertaking to abrogate contracts which it has previously reviewed and approved on an individual basis under Section 7 of the Act is an important one which this Court should decide.

The Commission justifies its decision to proceed by informal rulemaking on the ground that "legislative facts" rather than "disputed, adjudicated facts" were involved. App. at 273. The court below agreed. Relying on decisions of this Court with respect to the discretion which administrative agencies have in determining whether to proceed by rulemaking or adjudication, the court of appeals held that the Commission's decision to proceed under the circumstances here by rulemaking "passes muster under our deferential standard of review." App. at 51. Referring to the "industrywide effects" of minimum bill and minimum take provisions, the court below stated:

> The generalized nature of the problems addressed, therefore, did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking, particularly appropriate for determination of legislative facts and policies of general, prospective applicability, was a manifestly reasonable method of addressing the systemic problems of the natural gas market.

App. at 52.

This Court has made clear, however, that informal procedures will not necessarily suffice under all circumstances. When an

agency is making a quasi-judicial determination by which a relatively small number of persons will be exceptionally affected, in each case, upon individual grounds, additional procedures may be required to afford due process. *See Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. 519 (1978). In *United States* v. *Florida East Coast Railway*, 410 U.S. 224, 242, 245 (1973), the Court noted that its decisions

> represent a recognized distinction in administrative law between proceedings for the purpose of promulgating policy-type rules or standards, on the one hand, and proceedings designed to adjudicate disputed facts in particular cases on the other.

Id. at 245. *See, also, Bi-Metallic Investment Co.* v. *State Board of Equalization*, 239 U.S. 441, 446 (1915); *Ohio Bell Telephone Co.* v. *Public Utilities Commission*, 301 U.S. 292, 304-05 (1937).

Order No. 380 deals with a limited number of contracts, each of which had been individually reviewed and approved under Section 7 of the Act.[9] Only shortly before Order No. 380 was promulgated, the Commission had concluded that minimum bill provisions involve unique factual questions which were required to be resolved in case-by-case adjudicatory proceedings. In *Columbia Gas Transmission Corp.* v. *Tennessee Gas Pipeline Co.*, 24 FERC ¶ 61,050, at 61,158 (1983), the Commission itself stated:

> [W]e find that the propriety of minimum bill provisions is case-specific and depends on facts and circumstances of the parties; therefore, we believe that the issue must be resolved on a case-by-case basis.

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[9] The Commission in Order No. 380-C noted that only five pipelines had submitted comments opposing elimination of minimum take provisions. App. at 235.

See also Northwest Central Pipeline Corp. v. *Arkansas Louisiana Gas Co.*, 24 FERC ¶ 61,092 at 61,235 (1983); *Transwestern Pipeline Co.*, 23 FERC ¶ 63,114 at 65,290 (1983).

The specific relationship between Transwestern's minimum bill and the take-or-pay provisions in its contracts with producers provide an example. In Order No. 380, the Commission stated that "there is no clear nexus between a pipeline's annual take-or-pay obligations and its minimum bills to its customers." App. at 103. Whatever may be the situation with respect to other pipelines, in Transwestern's case its minimum bill was specifically established at a level which would protect it against take-or-pay liability under its particular circumstances. In the Section 7 proceedings in which Transwestern was originally certificated, the Commission stated:

> The need for a high minimum bill is apparently caused in part at least by the take-or-pay provisions in Transwestern's gas purchase contracts.

Transwestern Pipeline Co., 22 FPC 391, 395 (1959).[10]

Essentially the court below upheld the Commission on the theory that, in rate matters, the hearing requirements of Section 5 could be satisfied through informal rulemaking proceedings under Section 4 of the Administrative Procedure Act. Reasoning that the treatment of minimum take and minimum bill provisions were "ratemaking" matters, Section 403(c) of the Department of Energy Organization Act, 42 U.S.C. § 7173(c) (1982), taken with the lower court's earlier decision in *American Public Gas Association* v. *FPC*, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978), were regarded as authoritative. App. at 25.

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[10] As Transwestern has historically been a higher-cost supplier than its principal competitor, El Paso, the minimum bill and minimum take provisions in its contracts were incorporated and approved to assure continued sales. *Cf. Transwestern Pipeline Co.*, 22 FPC 542, 543 (1959).

The court below erred in two significant respects.

First, on its face and as clearly reflected from its legislative history, Section 403 deals narrowly with "the establishment of rates." *See* S. Rep. No. 164, 95th Cong., 1st Sess. 40-41 (1977), *reprinted in* 1977 U.S. Code Cong. & Admin. News at 894-95. It does not purport even in that respect, however, to authorize the use of *informal* rulemaking proceedings in all cases.

> Any function described in Section 7172 of this title which relates to the establishment of rates and charges under the Federal Power Act [16 U.S.C.A. § 791(a), *et seq.*] or the Natural Gas Act [15 U.S.C. § 717, *et seq.*] may be conducted by rulemaking proceedings. Except as provided in Subsection (d) of this section, the procedures in such a rulemaking proceeding shall assure full consideration of the issues and an opportunity for interested persons to present their views.[11]

App. at 292.

Second, minimum take provisions require the purchase of minimum agreed volumes. They do not even remotely involve "the establishment of rates."

The reach of Section 403 has not previously been before this Court. The court below erroneously expanded the authority of that section well beyond any reasonable construction. This Court should review to correct.

Furthermore, even accepting *arguendo* that the Commission's action with respect to the elimination of variable costs and minimum bills involved rate matters, which can be handled through rulemaking, the question remains whether untested comments submitted in informal rulemaking proceedings by parties seeking relief from their contract obligations constitute

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[11] Section 7172 transfers the functions of the Federal Power Commission to the Federal Energy Regulatory Commission. Subdivision (d) of Section 7173 deals with rates and charges for the first sale of natural gas by a producer.

"substantial evidence" under Section 19 of the Natural Gas Act, 15 U.S.C. § 717r(b) (1982).[12] In its earlier decision in *Mobil Oil Corp.* v. *FPC*, 483 F.2d 1238, 1251 (D.C. Cir. 1973), the court below had held that the test of the appropriateness of a particular type of procedure is whether it enabled the Commission to acquire the information needed to discharge its responsibilities under the Natural Gas Act effectively. It stated:

> Informal comments simply cannot create a record that satisfies the substantial evidence test. Even if controverting *information* is submitted in the form of comments by adverse parties, the procedure employed cannot be relied upon as adequate. A "whole record," as that phrase is used in this context, does not consist merely of the raw data introduced by the parties. It includes the process of testing and illumination ordinarily associated with adversary, adjudicative procedures. Without this critical element, informal comments, even by adverse parties, are two halves that do not make a whole. Thus, it is adversary procedural devices which permit testing and elucidation that raise information from the level of mere inconsistent data to evidence "substantial" enough to support rates.

Id. at 1260 (emphasis in original).

The court reiterated these standards in subsequent decisions. *Iowa State Commerce Commission* v. *Office of Federal Inspector*, 730 F.2d 1566, 1574 (D.C. Cir. 1984); *National Association of Broadcasters* v. *Copyright Royalty Tribunal*, 675 F.2d 367, 375 (D.C. Cir. 1982); *Farmers & Merchants Bank* v. *Board of Governors*, 567 F.2d 1082 (D.C. Cir. 1977). *See also Union Oil Co.* v. *FPC*, 542 F.2d 1036 (9th Cir. 1976).

In affirming Order No. 380, however, the court reversed itself on the basis of its reading of this Court's decision in *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. 519 (1978), and held that *Mobil* was "no longer good law." App. at

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[12] Section 313 of the Federal Power Act contains virtually identical provisions. App. at 293.

54. *Vermont Yankee* was interpreted as prohibiting a reviewing court from determining, in the context of the particular circumstances, the procedural requirements necessary to a "fair hearing." App. at 54.

The court misread *Vermont Yankee*. There this Court explicitly recognized that, under situations involving fact-specific findings affecting a limited number of companies, due process might require more than the procedures outlined in Section 4 of the Administrative Procedure Act. *Id.* at 542 n.17. It is thus important for this Court to review in order to clarify the effect of its decision in *Vermont Yankee* in the context of the facts here and to determine whether the "statutory minima" of informal rulemaking can be employed to abrogate contracts and certificated service arrangements, which the Commission has previously reviewed under Section 7 of the Act and found to be required by the public convenience and necessity.

In sum, whether the informal rulemaking procedures of Section 4 of the Administrative Procedure Act are adequate to satisfy the requirements of due process in the context of the issues here, whether they are adequate to satisfy the hearing and substantial evidence requirements of Sections 5 and 19 of the Act (and by implication Sections 206 and 313 of the Federal Power Act, 16 U.S.C. §§ 824d, 8251 (1982)), whether this Court's decision in *Vermont Yankee* relaxed the standards necessary for the abrogation of contracts, whether Section 403 of the Department of Energy Organization Act authorized contract abrogation through the type of rulemaking procedures provided here are all significant issues having far-reaching effect on the pipeline industry, and clearly merit review by this Court.

3. This Court Should Address the Conflict Between Contract Integrity and What Order No. 380 Determines to Be the "Anti-Competitive" Effect of Contracts Requiring the Purchase of Specified Volumes of Gas.

The question whether a contract provision which requires or induces the purchase of a minimum volume of gas is *per se* anti-competitive and therefore unjust and unreasonable is a significant one which this Court should address. Commitments on the one hand to sell and on the other hand to buy are the essence of any sales transaction. The effect of Order No. 380, in rendering purchase obligations unenforceable, significantly impairs the right, as well as the inclination, of regulated companies to enter into contracts for long-term supply arrangements. If the ability to contract does not include the ability to obtain an enforceable commitment to purchase a particular volume of gas, the right has little meaning.

The Commission, with approval of the court below, has reasoned that pipeline companies cannot by contract require their customers to purchase any particular minimum quantity of gas because to do so necessarily precludes the customer from purchasing equivalent volumes of gas from other sources. This is true. But does it follow, as the Commission further reasons, that such contracts are therefore "anti-competitive" and unlawful? Summarizing and approving the Commission's rationale, the court says:

> As a practical matter, there is no difference between the two [minimum bill and minimum take] contract provisions because, in the case of the minimum bill, customers rarely pay for gas not taken. More importantly, there is no difference between the two types of clauses with respect to the Commission's rationale for the rule; both provisions have the same negative impacts on the natural gas market. Although minimum take provisions do not require customers to pay for gas that they never receive, *the provisions, perhaps more so than minimum bills, impede price*

> *competition among pipelines. A minimum take customer must physically take a minimum quantity of gas, thereby foregoing a cheaper alternative. Thus, the anticompetitive effects of the minimum take provisions are the same as those of minimum bills, and the Commission's rationale properly applies to both.*

App. at 35, n. 18 (emphasis added).

This fallacious reasoning may be contrasted with this Court's observation in *Chicago Board of Trade* v. *United States*, 246 U.S. 231, 238 (1918):

> [T]he legality of an agreement . . . cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade . . . restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition.

In *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651 (1964), this Court recognized that, under the circumstances that prevail in the natural gas industry, long-term contracts involving commitments to purchase gas are not only reasonable, they are indispensable:

> In this regulated industry a natural gas company (unless it has excess capacity) must compete for, enter into, and then obtain Commission approval of sale contracts in advance of constructing the pipeline facilities. In the natural gas industry pipelines are very expensive; and to be justified they need long-term contracts for sale of the gas that will travel them. Those transactions with distributors are few in number. For example, in California there are only two significant wholesale purchasers — Pacific Gas & Electric in the north and the Southern Companies in the south. Once the Commission grants authorization to construct facilities or to transport gas in interstate commerce, once the distributing contracts are made, a particular market is withdrawn from competition. *The competition then is for the new increments of demand that may emerge with an*

> *expanding population and with an expanding industrial or household use for gas.*

Id. at 659-60 (emphasis in original).

This Court's statement in *El Paso,* which specifically addresses the very issue of the interrelationship of contracts and competition, is in categorical conflict with the rationale underlying Order No. 380. Whether this or any particular Commission has the authority pursuant to "comments" submitted in informal rulemaking proceedings to transform the nature of the natural gas pipeline industry by prohibiting long-term purchase commitments is a matter of substantial importance warranting review by this Court.

4. This Court Should Review to Determine Whether the Commission Can Lawfully Abrogate Only that Part of Transwestern's Contracts which Required Its Customers to Purchase Gas and Purportedly Leave in Effect the Remainder of the Contract Requiring Transwestern to Provide Firm Service at Contracted Levels.

Through Order No. 380, the Commission abrogated that portion of Transwestern's contracts, and those of other pipelines, requiring the purchase of specified minimum volumes of gas but purported to leave in place that portion of its contracts requiring it to sell specified volumes of gas. Whether Section 5 of the Act, under which the Commission has purported to act, authorizes the Commission to abrogate only the purchase commitment under the contract and to leave in place the sale commitment is a significant question, directly implicated by Order No. 380, which the Court should address. While the Commission may have authority to abrogate a contract which it has previously reviewed and approved, that authority does not extend to the abrogation of such an essential element of the contract as a purchase obligation while purportedly leaving in effect the corresponding sales obligation. *Cf.* Aldisert, dissenting, *Gulf Oil*

Corp. v. *FPC*, 563 F.2d 588, 616 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978):

> Simply put, the Commission cannot have it both ways. It cannot approve a contract as the basis of a certificate in the public interest and later, after performance by the parties, abrogate crucial portions of the approved contract ostensibly in the same public interest. Although cloaked with much authority, the Commission has no power to rewrite a contract it has approved.

5. This Court Should Review to Correct the Commission's Failure to Address Purchase Obligations in Pipeline Contracts with Producers.

While eliminating the pipeline customer's obligation to purchase any particular volume of gas, Order No. 380 left intact the pipeline's corresponding contractual commitment with its producer/suppliers, reasoning *inter alia* that there was no "clear nexus" between take-or-pay commitments and minimum bill obligations. See App. 38-39, 182, 211-212. As noted, in Transwestern's case a direct relationship has historically existed. See Transwestern Pipeline Company 22 FPC 542 (1959). Apart from that fact, however, virtually all producer contracts with pipelines contain take-or-pay and minimum take provisions. Assuming, *arguendo*, the authority of the Commission to abrogate and proscribe contracts between pipelines and their customers through informal rulemaking proceedings, the Commission acted arbitrarily in refusing to grant relief from take-or-pay and minimum take provisions in producer contracts. Such refusal has left Transwestern and other pipelines whose markets have been reduced or eliminated exposed to many millions of dollars of claims under their respective producer contracts.[13] Whether the Commission could lawfully deal only with take-or-

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[13] Transwestern estimates that if take-or-pay claims are asserted against it by all of its producers the amount for the year 1985 alone will approach $200 million. Transwestern has invoked force majeure as a result of Order No. 380 as a defense to claims which have been asserted. Such claims persist, however.

pay provisions in pipeline sales contracts and disregard corresponding provisions in producer contracts is a matter of critical importance to the pipeline industry which this Court should address.

6. This Case Presents the Issue of the Commission's Authority, Through Informal Rulemaking Proceedings, to Revoke or Substantially Modify Certificates of Public Convenience and Necessity to Serve Particular Markets.

Section 7 of the Act requires that any company proposing to offer jurisdictional service first apply for and receive a certificate from the Commission authorizing the proposed service. 15 U.S.C. § 717f(c)(1)(A) (1982). Once certification has been received and service has commenced, the company may not abandon service except upon the prior approval of the Commission. *Id.* § 717f(b). Except for certain limited circumstances not relevant here, *see id.* § 717f(a), however, the Commission may not compel a natural gas company to provide service that it is unwilling to render or to provide service it is willing to render on terms it finds unacceptable. *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 387-88 (1959). The Commission has the authority to attach conditions to its issuance of a certificate authorizing service for which permission has been sought, *Florida Power & Light Co.* v. *FERC*, 598 F.2d 370 (5th Cir. 1979), *cert. denied*, 444 U.S. 1013 (1980), but, in such a case, the applicant may reject the proffered certificate and decline to provide the service if it finds the conditions unacceptable, *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. at 387-88.

This Court concluded that an administrative agency cannot revoke or substantially modify a certificate once it has been issued and accepted when it considered analogous provisions of the Interstate Commerce Act. *See United States* v. *Seatrain Lines, Inc.*, 329 U.S. 424, 429-32 (1947). Similarly, in *CAB* v. *Delta Air Lines*, 367 U.S. 316, 322-25 (1961), the Court held

that the authority to revoke or amend a certificate would not be presumed where it was not explicit. A contrary conclusion would render meaningless the applicant's right to reject a conditioned certificate. The Commission could offer a certificate on acceptable terms and then, once the company had accepted the certificate and become subject to the abandonment requirements of the Act, impose changes in terms which would have caused the company to reject the certificate had the new terms been presented as conditions to initial certification. As articulated by an FERC Administrative Law Judge, the policy behind

> the sanctity or security of the certificate or authorization once granted and put in operation is the simple fact that massive investments must be and are made to construct facilities in reliance on the conditions and permanence for the prescribed term of the certificates issued by the Commission. Without such security, businessmen and investment institutions would not enter into such projects nor lend the necessary funds to make the projects possible. The record in this case leaves absolutely no doubt that investment funds will *not* be available if certificates, in the absence of violations, can be revoked by the granting agency at will for political or other reasons such as supply changes, pricing, *etc.*

Trunkline LNG Co., 22 FERC ¶ 63,028 at 65,138 (1983) (emphasis in original).

Though the structure of the Act, this Court's decisions in *Seatrain* and *Delta*, as well as substantial policy considerations, would suggest that the Commission is without authority to revoke or amend certificates issued under Section 7 of the Act — whether through informal rulemaking proceedings or otherwise — the question has never been squarely decided. As the Commission observed in 1983:

> The issue is extremely difficult. Neither this Commission nor its predecessor, the Federal Power Commission, has directly passed on the question.

Trunkline LNG Co., 22 FERC ¶ 61,245 at 61,442 (1983).

Order No. 380, taken with Section 7 of the Act, requires Transwestern to stand ready to provide 750,000 Mcf per day to PLGS. It enables PLGS, however, to take from Transwestern only when its needs are not met by other suppliers. Similarly, with respect to NWC, it is not only relieved of its obligation to take or pay for minimum volumes of gas from Transwestern, it is enabled to purchase from Transwestern only when such supplies are needed to meet peakday requirements. The service Transwestern was certificated to perform is thus converted from a "baseload" type of service to a "peaking" type of service. The type of service it is now required to provide as a result of Order No. 380 and Section 7 of the Act is plainly quite different from that which it indicated at the time of initial certification it was "able and willing . . . to perform." See Section 7(e), Natural Gas Act, 15 U.S.C. § 717f(e) (1972).

The court of appeals rejected the contention that service obligations had been unlawfully revoked by Order No. 380. It reasoned that Order No. 380 did not affect authorized service; rather, the court stated:

> Even assuming *arguendo* that the Commission has no authority to amend or revoke certificated service in a section 5 proceeding, the elimination of minimum bills [and minimum take provisions][14] has no effect on the pipeline's *authorized* service. The Order merely addresses the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5.

App. at 25-26, n. 9 (emphasis in original).

As noted, minimum take provisions deal with volumes, not rates. A certificated service which involves no assurance of any minimum daily delivery level is plainly different from one which involves an assured market of 600,000 Mcf per day.

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[14] The court below stated that, unless otherwise indicated, it uses the term "minimum bill" to include "minimum take" provisions. App. at 19, n. 3.

Whether this Court's decision in *El Paso* correctly states the law regarding certificated markets, whether the Commission can, through the exercise of its Section 5 authority, effectively revoke a certificate of public convenience and necessity issued under Section 7 of the Act to serve a particular market, and whether it did so in Order No. 380 are likewise significant issues affecting Transwestern and the entire industry and provide further warrant for this Court's review of the decision below.

CONCLUSION

This Court should issue its writ of certiorari to review the decision of the court below.

Respectfully submitted,

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Petition
Appendix

LETTERHEAD OF
TRANSWESTERN PIPELINE COMPANY

September 25, 1967

Pacific Lighting Service and Supply Company
720 West Eighth Street
Los Angeles, California 90017

Gentlemen:

This will evidence our agreement to sell to you and your agreement to buy from us an additional 110,000 Mcf of Contract Demand Volumes under our current Federal Power Commission Gas Tariff and Service Agreement modified only in accordance with the following provisions:

1. The CDQ and MDDQ shall be 750,000 Mcf per day. The provision regarding the MDTQ shall be unchanged except that the volume now stated shall be increased from 512,000 to 600,000 Mcf per day.

2. Deliveries hereunder shall commence on November 1, 1968, or at such later date as Seller's facilities required to render such service are completed.

3. Transwestern will file with the Federal Power Commission an initial rate for the 750,000 Mcf per day CDQ volumes to be effective upon commencement of deliveries hereunder and to be determined as follows:

(a) If Transwestern commences deliveries to Cities Service Gas Company ("Cities") pursuant to authorization issued in Docket No. CP67-339 prior to the date it commences service under this agreement, the initial rate for the 750,000 Mcf per day CDQ deliveries shall be a demand/commodity rate equal to 31.00¢ per Mcf at a 100% contract demand level adjusted, however, by adding the amount per Mcf by which Transwestern's average cost of gas exceeds 16.90¢ per Mcf or deducting the amount per Mcf by which such cost of gas is below 16.60¢ per Mcf. Transwestern's average cost of gas shall be determined on the basis of estimated purchases, after the removal of inerts, to meet Transwestern's system wide requirements for the first twelve months of operations at

the 750,000 Mcf per day CDQ level and rounded to the nearest 1/100th cent.

(b) If deliveries commence hereunder before Transwestern commences such service to Cities, the initial rate for the 750,000 Mcf per day CDQ deliveries shall be a demand/commodity rate equal to 31.25¢ per Mcf at a 100% contract demand level adjusted, however, by adding the amount by which Transwestern's average cost of gas exceeds 16.90¢ per Mcf or deducting the amount by which such cost of gas is below 16.60¢ per Mcf, such average cost of gas to be determined on the basis set forth in (a) above.

4. If deliveries commence hereunder before Transwestern commences deliveries to Cities pursuant to authorization issued in Docket No. CP67-339, then at such time as such deliveries to Cities do commence, Transwestern shall file a CDQ-1 rate to Pacific Lighting for the 750,000 Mcf per day deliveries at a demand/commodity rate equal to 31.00¢ per Mcf at a 100% contract demand level adjusted, however, by adding the amount by which Transwestern's average cost of gas exceeds 16.90¢ per Mcf or deducting the amount by which such cost of gas is below 16.60¢ per Mcf determined on the basis of estimated purchases, after the removal of inerts, to meet system wide requirements for the succeeding twelve months of operations, rounded to the nearest 1/100th cent.

5. If the initial rate for the 750,000 Mcf per day CDQ volumes exceeds 31.25¢, before the commencement of deliveries to Cities pursuant to authorization issued in Docket No. CP67-339, or 31.00¢, after that time, due to increased gas purchase costs as provided for in Paragraphs 3 and 4, and Transwestern receives refunds attributable to such increased costs, Transwestern shall flow through to Pacific Lighting that portion of the refunded costs which caused the initial rate to exceed 31.25¢ or 31.00¢, as the case may be. This obligation shall apply only to refunds for gas purchased by Transwestern prior to the earlier of the date that a rate increase filing by Transwestern covering rates to Pacific Lighting is placed in effect, or the effective

date of any change in rates resulting from any rate proceeding under the Natural Gas Act instituted by the Federal Power Commission against Transwestern, and this paragraph shall have no further force or effect thereafter.

6. Following commencement of deliveries to Pacific Lighting at the 750,000 Mcf per day level, if at any time and from time to time Transwestern's average cost of gas is below 16.60¢ per Mcf determined in the manner provided in Article IV of the May 1, 1967 Stipulation and Agreement filed in Docket No. RP67-8, but also taking into account estimated purchases, after the removal of inerts, to meet Transwestern's system wide requirements for the succeeding twelve months of operations, then Transwestern shall file a reduction in its then effective CDQ-1 rate to Pacific Lighting to reflect the amount by which Transwestern's average cost of gas as so determined is less than 16.60¢ per Mcf to the extent such lower average cost of gas has not theretofore been reflected in Transwestern's rate; provided, however, Transwestern's obligations to file rate reductions under this Paragraph 6 shall terminate and this paragraph shall have no further force and effect on the earlier of the date that a rate increase filing by Transwestern covering rates to Pacific Lighting is placed in effect or the effective date of any change in rates resulting from any rate proceeding under the Natural Gas Act instituted by the Federal Power Commission against Transwestern. If rate reductions are required pursuant to this paragraph, they shall be made effective as of the January 1, April 1, July 1 or October 1 date following the decrease in Transwestern's average cost of gas which required such rate reduction. No reduction shall be required, however, unless the unit reduction determined as provided above equals or exceeds one-tenth of one cent per Mcf. Such reduced rate shall be rounded off to the nearest 1/100th cent per Mcf. Any amount collected subsequent to the effective date of such reduced rate in excess thereof shall be refunded without interest.

7. Transwestern agrees to proceed promptly to make the necessary filings for Federal Power Commission approval for the delivery of the additional 110,000 Mcf

CDQ volumes provided hereunder. Transwestern and Pacific Lighting shall each have the right to cancel this agreement if the authorization granted by the Federal Power Commission is not in a form and substance satisfactory to each party. If all necessary Federal Power Commission authorization has not been received and accepted by April 1, 1968, then at any time thereafter prior to the acceptance of such certificate, either Transwestern or Pacific Lighting shall have the right to terminate this agreement by giving written notice of termination to the other.

8. Pacific Lighting shall have the option to require Transwestern to install facilities which will enable Transwestern to deliver an MDDQ in excess of 750,000 Mcf per day at a mutually agreeable initial rate whether or not the CDQ is increased above 750,000 Mcf per day.

9. This agreement or the filing of any rate reduction pursuant hereto shall not in any respect restrict, prejudice or affect Transwestern's right to file increased rates at any time or to make tariff changes or other filings permitted under its Federal Power Commission Gas Tariff now in effect pursuant to Article 3.2 of our present Service Agreement or Pacific Lighting's rights as provided therein to oppose such filings; it being further specifically understood that nothing herein shall be construed as constituting an agreement upon any principle, method or cost of service used in determining the rates provided for and neither this agreement nor any rate reduction filed pursuant hereto shall be used for any purpose in any Transwestern rate proceeding.

10. The parties shall execute and Transwestern shall file with the Federal Power Commission a new Service Agreement and such tariff revisions as shall be necessary to reflect the above modifications of its present Federal Power Commission Gas Tariff and Service Agreement. Such Service Agreement shall provide that the initial 20 year term shall commence on the effective date of such new Service Agreement.

If the foregoing correctly expresses our agreement, please so indicate by signing in the space provided below.

Yours very truly,

TRANSWESTERN PIPELINE
COMPANY

By: Original Signed By W. A. Koros
W. A. KOROS,
Vice President

ACCEPTED AND AGREED TO:

PACIFIC LIGHTING SERVICE AND
SUPPLY COMPANY

By: Original Signed By William L. Cole
Vice President

GAS SALES AGREEMENT

IT IS HEREBY AGREED by and between TRANSWESTERN PIPELINE COMPANY, a Delaware corporation ("Seller") and CITIES SERVICE GAS COMPANY, a Delaware corporation ("Buyer") that Seller shall sell and deliver to Buyer, and Buyer shall purchase from Seller and pay for, natural gas on the terms and conditions hereinafter set forth:

1. Definitions and References

An MCF is one thousand (1,000) cubic feet of gas at a base temperature of sixty degrees (60°) Fahrenheit and at a pressure base of 14.73 pounds per square inch absolute.

"Contract Year" or "Years" refers to a period beginning at 7:00 A.M. on the day of initial delivery of gas hereunder and ending at 7:00 A.M. on the first day of the next calendar year, and each calendar year thereafter.

"Contract Demand Quantity" or "CDQ" refers to the total volume of gas to be purchased and sold from time to time hereunder or each day under Part 2 below.

2. Quantity

Seller agrees to sell and deliver to Buyer, and Buyer agrees to take:

a. A CDQ of 50,000 Mcf for the contract years 1964 and 1965.

b. A CDQ of 100,000 Mcf beginning January 1, 1966.

c. At Buyer's request, Seller agrees to use its best efforts to deliver into Buyer's pipeline at the delivery points herein provided for, and through the facilities installed by Seller for delivering the CDQ volumes, such volumes in addition to the CDQ volumes which Seller is able to deliver. Further, at any time Seller's overall gas supply exceeds its market requirements, Seller will attempt to work out an arrangement to sell such gas to Buyer.

d. If during any one year period after January 1, 1966, Seller is unable to deliver an average daily quantity of 100,000 Mcf, the average daily quantity of gas so delivered by Seller during such year shall be the daily quantity Buyer shall be obligated to purchase each year thereafter, unless in a subsequent year a lesser quantity is so established, and thereupon each time a lesser quantity is so established then such lesser quantity shall be the quantity of gas Buyer shall be obligated to purchase each year thereafter during the term of this agreement.

3. Pressure and Point of Delivery

Seller shall deliver the gas to Buyer into Buyer's Guymon-Blackwell 26-inch pipeline at two delivery points. One delivery point will be at the intersection of Buyer's said 26-inch line with Seller's pipeline in the vicinity of the Doby Springs Field, Harper County, Oklahoma, and the other delivery point will be in the area of the Mocane and Laverne Fields in Beaver County, Oklahoma, also on Buyer's said 26-inch line, at a point to be mutually agreed upon by the parties. Seller shall install such facilities as may be required to make delivery of the volumes covered hereby, and Buyer shall install such facilities as may be required for it to receive such volumes. The delivery pressure at the two delivery points shall be such pressure as is required to deliver the gas into Buyer's 26-inch line, but in no event shall the delivery pressure at either delivery point be in excess of 725 psig.

4. Price

a. The price to be paid by Buyer to Seller for the gas shall be 20¢ per Mcf for the first six Contract Years. Such price is based on an assumed purchased gas cost of 16.7¢ per Mcf. Except for changes to reflect increases or decreases in purchased gas costs, neither Buyer nor Seller shall institute any proceeding with the Federal Power Commission which would change such rate for the first six Contract Years.

b. For all gas sold after the end of the sixth Contract Year, the price shall be in accordance with rate schedules and applicable tariffs filed by Seller with the Federal Power Commission. Seller shall have the right, from time to time, to file such rate schedules and tariffs to be effective after the expiration of said Sixth Contract Year and base the same on a rate of return satisfactory to Seller. Buyer shall have the right to protest any rate or tariff so filed with the Federal Power Commission.

c. *Billing.* Seller shall bill Buyer on or before the tenth day of each month for gas delivered during the preceding month in accordance with Seller's applicable rate schedule and Buyer shall pay Seller on or before the twentieth day of such month for sums due for the preceding month.

d. *Minimum Purchase Obligation.* After commencement of deliveries hereunder, the minimum volume to be taken by Buyer each month shall be 50% of the CDQ times the number of days in the month (minimum monthly contract volume) during the Contract Year 1964 and 70% of the CDQ times the number of days in the month (minimum monthly contract volume) during the Contract Year 1965. For each month during the Contract Years 1964 and 1965, in which Buyer fails to take the minimum monthly contract volume, Buyer shall, within 30 days after the end of each such year, pay Seller for the difference between the minimum monthly contract volume and the actual deliveries for such month without offsetting gas taken in excess of the minimum monthly contract quantity in any other month. For subsequent Contract Years, if Buyer fails to take at least 90% of the quantities it is obligated to take hereunder (100,000 Mcf times the number of days in the Contract Year), then Buyer shall within 30 days after the end of such Contract Year make payments to Seller for its deficiency below said 90% in takes during such Contract Year.

e. *Deficiency Gas.* If for any Contract Year commencing with 1966 Buyer should pay for gas not taken (referred to hereafter as deficiency gas), Buyer shall have the right for the next succeeding five years to take during any such Contract Year or Years such volumes as may be available over the CDQ times the number of days in the Contract Year so as to make up such gas previously paid for but not taken without further payment. Provided, that if the rate in effect at the time of taking any such deficiency gas is different from the rate in effect when such gas should have been taken and for which payment has been made, then an adjustment shall be made to reflect such difference.

5. Term

This Agreement shall be in effect for an initial term of twenty (20) years from and after the date of initial delivery of gas hereunder.

6. Warranty

Seller warrants that it owns or controls natural gas reserves free of claims of any other persons from which it can sell and deliver the quantities of natural gas herein provided for.

7. Regulatory Approval and Right of Termination

Buyer and Seller agree to proceed immediately to make the necessary filing for Federal Power Commission approval of the delivery and receipt of the gas contemplated herein. If the Federal Power Commission approves the deliveries contemplated hereby upon conditions (including price) which are materially different from the terms of this Agreement and are unacceptable to either Seller or Buyer, the party to whom such conditions are unacceptable shall for a period of thirty (30) days after the final issuance of such certificate have the right to terminate this Agreement.

8. Quality.

All gas delivered by Seller to Buyer shall conform to the following specifications:

a. *Heat Content.* The gas to be delivered hereunder shall have a minimum total heating value of 1,000 BTU's per cubic foot.

b. *Oxygen.* The gas shall not at any time have an oxygen content in excess of 0.2 of 1% by volume, and Seller will make every reasonable effort to keep the gas free of oxygen.

c. *Liquids.* The gas shall be free of water and hydrocarbons in liquid form at the temperature and pressures at which the gas is delivered. The gas shall in no event contain water vapor in excess of 7 pounds per million standard cubic feet at the point of delivery.

d. *Hydrogen Sulphide.* The gas shall not contain more than 0.25 of 1 grain of hydrogen sulphide per hundred standard cubic feet.

e. *Organic Sulphur.* The gas shall not contain more than 0.5 grains per hundred cubic feet of noncorrosive organic sulphur other than sulphur in mercaptan form, nor more than 0.2 grains per hundred cubic feet of sulphur in mercaptan form.

f. *Carbon Dioxide and Nitrogen.* The total of the carbon dioxide and nitrogen components shall not be in excess of 6% by volume; provided, however, that the total CO_2 content shall not exceed 3% by volume.

g. *Dust, Gums, Etc.* The gas shall be commercially free of dust, gums, and other solid matter.

9. Seller to Conform to Specifications

a. If the gas offered for delivery by Seller shall fail at any time to conform to any of the quality specifications set forth

above, Buyer will notify Seller of such deficiency and if Seller fails to remedy such deficiency promptly, Buyer may, at its option, refuse to accept further delivery pending correction by Seller, or, Buyer may accept delivery of such gas and make changes necessary to bring such gas into conformity with the specifications, for which Seller shall reimburse Buyer for any reasonable expense incurred by Buyer in effecting such changes.

b. Within the limits of the minimum heating value specifications herein specified, Seller shall have the right before delivery of the gas to Buyer to remove from the gas delivered hereunder any constituent thereof other than methane and shall have the right to remove such methane as is necessarily removed from gas in the process of removing other constituents.

10. Tariff

Seller shall file with the Federal Power Commission a gas tariff in compliance with applicable laws and regulations pertaining thereto which shall include a Rate Schedule, General Terms and Conditions, and Form of Service Agreement, all substantially in the form attached hereto as Exhibit A. Subject to any changes required by the Federal Power Commission in the form of such Tariff, it is hereby incorporated herein by reference and made a part hereof for all purposes. Seller and Buyer shall each have the right to take such action with regard to such filing as is deemed advisable in the sole discretion of the respective parties. Upon the final approval by the Federal Power Commission of the form of such Tariff, and if neither party exercises its right of cancellation under Part 7 above, Seller and Buyer shall enter into a Service Agreement in the form so approved by the Federal Power Commission with the Rate Schedule and General Terms and Conditions being made a part thereof, provided, however, that such Service Agreement shall neither supersede, cancel, nullify nor amend any term or provision hereof except to the extent that same specifically conflicts with a term or provision hereof.

11. Prior Agreements

This Agreement shall supersede and take the place of all prior agreements between Buyer and Seller and/or Trans-Cities Pipeline Company covering the sale and delivery of natural gas, and all such agreements are hereby rescinded. Trans-Cities Pipeline Company joins herein for the purpose of evidencing that all prior gas purchase and sales agreements between it and Buyer or Seller have been cancelled.

12. Force Majeure

a. Neither party shall be liable in damages to the other on account of "Force Majeure" occasioned by any act, omission or circumstances occasioned by or in consequence of any act of God, strikes, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, arrests and restraints of rulers and people, civil disturbances, explosions, breakage or accident to machinery or lines of pipe, temporary failure of gas supply, the binding order of any court or governmental authority which has been resisted in good faith by all reasonable legal means, and any other cause, whether of the kind herein enumerated or not, and not within the control of the party claiming suspension and which by the exercise of due diligence such party is unable to prevent or overcome. However, failure to settle or prevent any strikes or other controversy with employees or with anyone purporting or seeking to represent employees shall not be considered to be a matter within the control of the party claiming suspension.

b. Subject to the last sentence of Part 12.a. hereof, neither Buyer nor Seller shall be relieved from liability in the event of its concurring negligence or failure on its part to use due diligence to remedy the force majeure and remove the cause with all reasonable dispatch nor shall such causes or contingencies affecting performance of this agreement relieve either party

from their obligations to make payments then due in respect of gas theretofore delivered.

13. Laws and Regulations

This Agreement is subject to all valid laws, orders, rules, and regulations of duly constituted authority having jurisdiction.

EXECUTED this 1st day of October, 1963.

TRANSWESTERN
PIPELINE COMPANY
Seller

ATTEST:

/s/ W. A. KOROS
Assistant Secretary
(SEAL)

By /s/ BASIL P. KANTZER
President

CITIES SERVICE GAS
COMPANY
Buyer

ATTEST:

/s/ KENNETH E. MANNER
Secretary
(SEAL)

By /s/ RUSSELL W. HOPSESS
Vice President

TRANS-CITIES PIPELINE
COMPANY

ATTEST:

/s/ KENNETH E. MANNER
Secretary
(SEAL)

By /s/ K. E. CRENSHAW
President

GAS SALES AGREEMENT

IT IS HEREBY AGREED by and between TRANSWESTERN PIPELINE COMPANY, a Delaware corporation ("Seller") and CITIES SERVICE GAS COMPANY, a Delaware corporation ("Buyer") that Seller shall sell and deliver to Buyer, and Buyer shall purchase from Seller and pay for, natural gas on the terms and conditions hereinafter set forth:

1. Definitions and References

An MCF is one thousand (1,000) cubic feet of gas at a base temperature of sixty degrees (60°) Fahrenheit and at a pressure base of 14.73 pounds per square inch absolute.

"Contract Year" or "Years" refers to a period beginning at 7:00 A.M. on the day of initial delivery of gas hereunder and ending at 7:00 A.M. on the first day of the first calendar month that begins after the expiration of twelve (12) full calendar months after initial delivery hereunder and each successive twelve (12) calendar months thereafter.

"Contract Demand Quantity" or "CDQ" refers to the total volume of gas to be purchased and sold from time to time hereunder on each day under Part 2 below.

2. Quantity

a. Seller agrees to sell and deliver to Buyer, and Buyer agrees to take:

(1) a CDQ of 100,000 MCF beginning November 1, 1968, increasing to

(2) a CDQ of 150,000 MCF beginning November 1, 1969, increasing to

(3) a CDQ of 200,000 MCF beginning November 1, 1970, increasing to

(4) a CDQ of 250,000 MCF beginning November 1, 1971.

b. At Buyer's request, Seller agrees to use its best efforts consistent with Seller's overall system operations to deliver to Buyer at the delivery point herein provided for, and through the facilities installed by Seller for delivering the CDQ volumes, such volumes in addition to the CDQ volumes which Seller is able to deliver.

c. If during any full Contract Year Seller is unable for any reason other than an event or events of Force Majeure to deliver an average daily quantity of gas equal to the CDQ specified in a. above, then the daily quantity Buyer shall be obligated to purchase each year thereafter shall be reduced by such average daily amount by which Seller was unable to deliver the CDQ, unless in a subsequent year a lesser quantity is so established, and thereupon each time a lesser quantity is so established then such lesser quantity shall be the quantity of gas Buyer shall be obligated to purchase each year thereafter during the term of this Agreement.

3. Delivery Point, Pressure and Facilities

a. Seller shall deliver gas hereunder to Buyer at or near the present northeasterly end of Seller's 24-inch pipeline in Hemphill County, Texas, at an interconnection to be made between Seller's existing 24-inch pipeline and a pipeline to be built by Buyer.

b. The delivery pressure shall be such pressure as is required to deliver the gas into Buyer's pipeline at the delivery point, but in no event shall Seller be required to deliver gas at a pressure in excess of 700 psig. Provided, however, if for any reason Seller operates its pipeline at pressures greater than 700 psig Buyer shall have the option to call for such higher delivery pressure at the delivery point so long as Seller operates at such higher pressure.

c. Seller shall install such facilities as may be required to make delivery of the volumes covered hereby, and Buyer shall

install such facilities as may be required for it to receive such volumes.

4. Price and Minimum Purchase Obligation

a. The initial rate to be paid by Buyer to Seller for gas delivered hereunder shall be a demand and commodity rate acceptable to both Buyer and Seller which equals 23¢ per MCF for 100% of the CDQ volumes. Neither Buyer nor Seller shall institute any proceeding with the Federal Power Commission which would change such rate for gas to be delivered on or before December 31, 1970.

b. Subject to the provisions of Paragraph 4.a. hereof Seller shall have the right, from time to time, to file changes in its Tariff and to increase or decrease the rate by the filing of new Rate Schedules or to change the form of the applicable Rate Schedule and to take such other and further action with respect thereto as may be legally permitted or required, and Buyer shall have the right to oppose any of the foregoing and to request reduction in rates to the extent that may be legally required or permitted.

c. Seller shall bill Buyer on or before the tenth (10th) day of each month for gas delivered during the preceding month in accordance with Seller's applicable Rate Schedule and Buyer shall pay Seller on or before the twentieth (20th) day of such month for sums due for the preceding month.

d. The minimum volume to be taken by Buyer each Contract Year shall be 90% of the CDQ times the number of days in the Contract Year. For each Contract Year, if Buyer fails to take at least 90% of the quantities it is obligated to take hereunder (the applicable CDQ times the number of days in the Contract Year), then Buyer shall within thirty (30) days after the end of such Contract Year make payment to Seller for its deficiency below said 90% in takes during such Contract Year.

e. If for any Contract Year Buyer should pay for gas not taken (referred to hereafter as deficiency gas), Buyer shall have the right for the next succeeding five (5) years to take during any such Contract Year or Years such volumes as may be available hereunder over the CDQ times the number of days in the Contract Year so as to make up such gas previously paid for but not taken without further payment. Provided, that if the rate in effect at the time of taking any such deficiency gas is different from the rate in effect when such gas should have been taken and for which payment has been made, then an adjustment shall be made to reflect such difference.

5. Term

This Agreement shall be in effect for an initial term of twenty (20) years from and after the date of initial delivery of gas hereunder.

6. Warranty

Seller warrants the title to all gas delivered to Buyer hereunder.

7. Regulatory Approval and Right of Termination

Buyer and Seller agree to proceed with diligence to make the necessary filings for Federal Power Commission approval of the delivery and receipt of the 150,000 MCF per day to be delivered under Part 2.a. (1) and (2) hereof. At a time to be mutually agreed upon, but in no event later than May 1, 1969, both parties shall make the necessary filings for Federal Power Commission approval of the delivery and receipt of the additional 100,000 MCF per day to be delivered under Parts 2.a. (3) and (4) hereof. If the Federal Power Commission approves the deliveries contemplated hereby upon conditions (including price) which are materially different from the terms of this Agreement and which are unacceptable to either Seller or Buyer, the party to whom such conditions are unacceptable shall for a period of

thirty (30) days after the final issuance of such certificate have the right to terminate this Agreement, except that such right of termination shall not extend any volumes to be delivered hereunder for which certificate authorization (whether temporary or permanent) has previously been accepted.

8. Quality

All gas delivered by Seller to Buyer shall conform to the following specifications:

a. *Heat Content.* The gas to be delivered hereunder shall have a minimum total heating value of 1,000 BTU per cubic foot saturated with water vapor.

b. *Oxygen.* The gas shall not at any time have an oxygen content in excess of 0.2 of 1% by volume, and Seller will make every reasonable effort to keep the gas free of oxygen.

c. *Liquids.* The gas shall be free of water and hydrocarbons in liquid form at the temperature and pressures at which the gas is delivered. The gas shall in no event contain water vapor in excess of seven (7) pounds per million standard cubic feet at the point of delivery.

d. *Hydrogen Sulphide.* The gas shall not contain more than 0.25 of 1 grain of hydrogen sulphide per hundred standard cubic feet.

e. *Organic Sulphur.* The gas shall not contain more than 0.5 grains per hundred cubic feet of noncorrosive organic sulphur other than sulphur in mercaptan form, nor more than 0.2 grains per hundred cubic feet of sulphur in mercaptan form.

f. *Carbon Dioxide and Nitrogen.* The total of the carbon dioxide and nitrogen components shall not be in excess of 6% by volume; provided, however, that the total CO_2 content shall not exceed 3% by volume.

g. *Dust, Gums, Etc.* The gas shall be commercially free of dust, gums, and other solid matter.

9. Seller to Conform to Specifications

a. If the gas offered for delivery by Seller shall fail at any time to conform to any of the quality specifications set forth above, Buyer will notify Seller of such deficiency and if Seller fails to remedy such deficiency promptly, Buyer may, at its option, refuse to accept further delivery pending correction by Seller, or, Buyer may accept delivery of such gas and make changes necessary to bring such gas into conformity with the specifications, for which Seller shall reimburse Buyer for any reasonable expense incurred by Buyer in effecting such changes.

b. Within the limits of the minimum heating value specifications herein specified, Seller shall have the right before delivery of the gas to Buyer to remove from the gas delivered hereunder any constituent thereof other than methane and shall have the right to remove such methane as is necessarily removed from gas in the process of removing other constituents.

10. Tariff

Seller shall file with the Federal Power Commission a new Rate Schedule and such changes in its FPC Gas Tariff as may be necessary to carry out the provisions of this Agreement. Seller and Buyer shall each have the right to take such action with regard to such Tariff as is deemed advisable in the sole discretion of the respective parties. Upon final approval by the Federal Power Commission of the changes in said Tariff and Seller's new Rate Schedule, and if this Agreement has not been terminated in its entirety under Part 7 above, Seller and Buyer shall enter into a Service Agreement in the form so approved by the Federal Power Commission with the Rate Schedule and General Terms and Conditions being made a part thereof, provided, however, that such Service Agreement shall neither supercede, cancel, nullify nor amend any term or provision hereof except to the extent that the same specifically conflicts with a term or provision hereof.

11. Force Majeure

a. Neither party shall be liable in damages to the other on account of "Force Majeure" occasioned by any act, omission or circumstances occasioned by or in consequence of any act of God, strikes, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, arrests and restraints of rulers and people, civil disturbances, explosions, breakage or accident to machinery or lines of pipe, temporary failure of gas supply, the binding order of any court or governmental authority which has been resisted in good faith by all reasonable legal means, and any other cause, whether of the kind herein enumerated or not, and not within the control of the party claiming suspension and which by the exercise of due diligence such party is unable to prevent or overcome. However, failure to settle or prevent any strikes or other controversy with employees or with anyone purporting or seeking to represent employees shall not be considered to be a matter within the control of the party claiming suspension.

b. Subject to the last sentence of Part 11a hereof, neither Buyer nor Seller shall be relieved from liability in the event of its concurring negligence or failure on its part to use due diligence to remedy the force majeure and remove the cause with all reasonable dispatch nor shall such causes or contingencies affecting performance of this Agreement relieve either party from their obligations to make payments then due in respect of gas theretofore delivered.

12. Laws and Regulations

This Agreement is subject to all valid laws, orders, rules, and regulations of duly constituted authority having jurisdiction.

EXECUTED this 10th day of March, 1967.

TRANSWESTERN PIPELINE COMPANY
Seller

By /s/ W. A. KOROS
Vice President

CITIES SERVICE GAS COMPANY
Buyer

By /s/ RUSSEL W. HOFSESS
Vice President

GAS SALES AGREEMENT

IT IS HEREBY AGREED by and between TRANSWESTERN PIPELINE COMPANY, a Delaware corporation ("Seller") and CITIES SERVICE GAS COMPANY, a Delaware corporation ("Buyer") that Seller shall sell and deliver to Buyer, and Buyer shall purchase from Seller and pay for, natural gas on the terms and conditions hereinafter set forth:

1. Definitions and References

An MCF is one thousand (1,000) cubic feet of gas at a base temperature of sixty degrees (60°) Fahrenheit and at a pressure base of 14.73 pounds per square inch absolute.

"Contract Year" or "Years" refers to a period beginning at 7:00 A.M. on the day of initial delivery of gas hereunder and ending at 7:00 A.M. on the first day of the first calendar month that begins after the expiration of twelve (12) full calendar months after initial delivery hereunder and each successive twelve (12) calendar months thereafter.

"Contract Demand Quantity" or "CDQ" refers to the total volume of gas to be purchased and sold from time to time hereunder on each day under Part 2 below.

2. Quantity

a. Seller agrees to sell and deliver to Buyer, and Buyer agrees to take:

(1) a CDQ of 100,000 MCF beginning November 1, 1968, increasing to

(2) a CDQ of 150,000 MCF beginning November 1, 1969, increasing to

(3) a CDQ of 200,000 MCF beginning November 1, 1970, increasing to

(4) a CDQ of 250,000 MCF beginning November 1, 1971.

b. At Buyer's request, Seller agrees to use its best efforts consistent with Seller's overall system operations to deliver to Buyer at the delivery point herein provided for, and through the facilities installed by Seller for delivering the CDQ volumes, such volumes in addition to the CDQ volumes which Seller is able to deliver.

c. If during any full Contract Year Seller is unable for any reason other than an event or events of Force Majeure to deliver an average daily quantity of gas equal to the CDQ specified in a. above, then the daily quantity Buyer shall be obligated to purchase each year thereafter shall be reduced by such average daily amount by which Seller was unable to deliver the CDQ, unless in a subsequent year a lesser quantity is so established, and thereupon each time a lesser quantity is so established then such lesser quantity shall be the quantity of gas Buyer shall be obligated to purchase each year thereafter during the term of this Agreement.

3. Delivery Point, Pressure and Facilities

a. Seller shall deliver gas hereunder to Buyer at or near the present northeasterly end of Seller's 24-inch pipeline in Hemphill County, Texas, at an interconnection to be made between Seller's existing 24-inch pipeline and a pipeline to be built by Buyer.

b. The delivery pressure shall be such pressure as is required to deliver the gas into Buyer's pipeline at the delivery point, but in no event shall Seller be required to deliver gas at a pressure in excess of 700 psig. Provided, however, if for any reason Seller operates its pipeline at pressures greater than 700 psig Buyer shall have the option to call for such higher delivery pressure at the delivery point so long as Seller operates at such higher pressure.

c. Seller shall install such facilities as may be required to make delivery of the volumes covered hereby, and Buyer shall

install such facilities as may be required for it to receive such volumes.

4. Price and Minimum Purchase Obligation

a. The initial rate to be paid by Buyer to Seller for gas delivered hereunder shall be a demand and commodity rate acceptable to both Buyer and Seller which equals 23¢ per MCF for 100% of the CDQ volumes. Neither Buyer nor Seller shall institute any proceeding with the Federal Power Commission which would change such rate for gas to be delivered on or before December 31, 1970.

b. Subject to the provisions of Paragraph 4.a. hereof Seller shall have the right, from time to time, to file changes in its Tariff and to increase or decrease the rate by the filing of new Rate Schedules or to change the form of the applicable Rate Schedule and to take such other and further action with respect thereto as may be legally permitted or required, and Buyer shall have the right to oppose any of the foregoing and to request reduction in rates to the extent that may be legally required or permitted.

c. Seller shall bill Buyer on or before the tenth (10th) day of each month for gas delivered during the preceding month in accordance with Seller's applicable Rate Schedule and Buyer shall pay Seller on or before the twentieth (20th) day of such month for sums due for the preceding month.

d. The minimum volume to be taken by Buyer each Contract Year shall be 90% of the CDQ times the number of days in the Contract Year. For each Contract Year, if Buyer fails to take at least 90% of the quantities it is obligated to take hereunder (the applicable CDQ times the number of days in the Contract Year), then Buyer shall within thirty (30) days after the end of such Contract Year make payment to Seller for its deficiency below said 90% in takes during such Contract Year.

e. If for any Contract Year Buyer should pay for gas not taken (referred to hereafter as deficiency gas), Buyer shall have the right for the next succeeding five (5) years to take during any such Contract Year or Years such volumes as may be available hereunder over the CDQ times the number of days in the Contract Year so as to make up such gas previously paid for but not taken without further payment. Provided, that if the rate in effect at the time of taking any such deficiency gas is different from the rate in effect when such gas should have been taken and for which payment has been made, then an adjustment shall be made to reflect such difference.

5. Term

This Agreement shall be in effect for an initial term of twenty (20) years from and after the date of initial delivery of gas hereunder.

6. Warranty

Seller warrants the title to all gas delivered to Buyer hereunder.

7. Regulatory Approval and Right of Termination

Buyer and Seller agree to proceed with diligence to make the necessary filings for Federal Power Commission approval of the delivery and receipt of the 150,000 MCF per day to be delivered under Part 2.a. (1) and (2) hereof. At a time to be mutually agreed upon, but in no event later than May 1, 1969, both parties shall make the necessary filings for Federal Power Commission approval of the delivery and receipt of the additional 100,000 MCF per day to be delivered under Parts 2.a. (3) and (4) hereof. If the Federal Power Commission approves the deliveries contemplated hereby upon conditions (including price) which are materially different from the terms of this Agreement and which are unacceptable to either Seller or Buyer, the party to whom such conditions are unacceptable shall for a period of

thirty (30) days after the final issuance of such certificate have the right to terminate this Agreement, except that such right of termination shall not extend any volumes to be delivered hereunder for which certificate authorization (whether temporary or permanent) has previously been accepted.

8. Quality

All gas delivered by Seller to Buyer shall conform to the following specifications:

a. *Heat Content.* The gas to be delivered hereunder shall have a minimum total heating value of 1,000 BTU per cubic foot saturated with water vapor.

b. *Oxygen.* The gas shall not at any time have an oxygen content in excess of 0.2 of 1% by volume, and Seller will make every reasonable effort to keep the gas free of oxygen.

c. *Liquids.* The gas shall be free of water and hydrocarbons in liquid form at the temperature and pressures at which the gas is delivered. The gas shall in no event contain water vapor in excess of seven (7) pounds per million standard cubic feet at the point of delivery.

d. *Hydrogen Sulphide.* The gas shall not contain more than 0.25 of 1 grain of hydrogen sulphide per hundred standard cubic feet.

e. *Organic Sulphur.* The gas shall not contain more than 0.5 grains per hundred cubic feet of noncorrosive organic sulphur other than sulphur in mercaptan form, nor more than 0.2 grains per hundred cubic feet of sulphur in mercaptan form.

f. *Carbon Dioxide and Nitrogen.* The total of the carbon dioxide and nitrogen components shall not be in excess of 6% by volume; provided, however, that the total CO_2 content shall not exceed 3% by volume.

g. *Dust, Gums, Etc.* The gas shall be commercially free of dust, gums, and other solid matter.

9. Seller to Conform to Specifications

a. If the gas offered for delivery by Seller shall fail at any time to conform to any of the quality specifications set forth above, Buyer will notify Seller of such deficiency and if Seller fails to remedy such deficiency promptly, Buyer may, at its option, refuse to accept further delivery pending correction by Seller, or, Buyer may accept delivery of such gas and make changes necessary to bring such gas into conformity with the specifications, for which Seller shall reimburse Buyer for any reasonable expense incurred by Buyer in effecting such changes.

b. Within the limits of the minimum heating value specifications herein specified, Seller shall have the right before delivery of the gas to Buyer to remove from the gas delivered hereunder any constituent thereof other than methane and shall have the right to remove such methane as is necessarily removed from gas in the process of removing other constituents.

10. Tariff

Seller shall file with the Federal Power Commission a new Rate Schedule and such changes in its FPC Gas Tariff as may be necessary to carry out the provisions of this Agreement. Seller and Buyer shall each have the right to take such action with regard to such Tariff as is deemed advisable in the sole discretion of the respective parties. Upon final approval by the Federal Power Commission of the changes in said Tariff and Seller's new Rate Schedule, and if this Agreement has not been terminated in its entirety under Part 7 above, Seller and Buyer shall enter into a Service Agreement in the form so approved by the Federal Power Commission with the Rate Schedule and General Terms and Conditions being made a part thereof, provided, however, that such Service Agreement shall neither supercede, cancel, nullify nor amend any term or provision hereof except to the extent that the same specifically conflicts with a term or provision hereof.

11. Force Majeure

a. Neither party shall be liable in damages to the other on account of "Force Majeure" occasioned by any act, omission or circumstances occasioned by or in consequence of any act of God, strikes, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, arrests and restraints of rulers and people, civil disturbances, explosions, breakage or accident to machinery or lines of pipe, temporary failure of gas supply, the binding order of any court or governmental authority which has been resisted in good faith by all reasonable legal means, and any other cause, whether of the kind herein enumerated or not, and not within the control of the party claiming suspension and which by the exercise of due diligence such party is unable to prevent or overcome. However, failure to settle or prevent any strikes or other controversy with employees or with anyone purporting or seeking to represent employees shall not be considered to be a matter within the control of the party claiming suspension.

b. Subject to the last sentence of Part 11a hereof, neither Buyer nor Seller shall be relieved from liability in the event of its concurring negligence or failure on its part to use due diligence to remedy the force majeure and remove the cause with all reasonable dispatch nor shall such causes or contingencies affecting performance of this Agreement relieve either party from their obligations to make payments then due in respect of gas theretofore delivered.

12. Laws and Regulations

This Agreement is subject to all valid laws, orders, rules, and regulations of duly constituted authority having jurisdiction.

EXECUTED this 10th day of March, 1967.

TRANSWESTERN PIPELINE COMPANY
Seller

By /s/ W. A. KOROS
Vice President

CITIES SERVICE GAS COMPANY
Buyer

By /s/ RUSSEL W. HOFSESS
Vice President

SERVICE AGREEMENT — FORM F

For Buyers Receiving Service Under Rate Schedule CDQ-3

This contract made between TRANSWESTERN PIPELINE COMPANY, hereinafter called "Seller", and CITIES SERVICE GAS COMPANY, hereinafter called "Buyer", whether one or more.

NOW, THEREFORE, in consideration of the mutual promises and agreements herein contained, the parties agree as follows:

Article 1 — Gas to be Purchased and Sold:

Seller agrees to sell and deliver to Buyer and Buyer agrees to purchase from Seller, for the term of this agreement, natural gas on the terms and conditions hereinafter set forth.

The CDQ to be delivered during each contract year is 150,000 Mcf per day; provided, however, that the CDQ shall be 75,000 Mcf per day for the first contract year and 100,000 Mcf per day for the second contract year. The contract year shall be a fiscal year commencing with date of first delivery.

If during any full contract year Seller is unable for any reason other than an event or events of force majeure to deliver an average daily quantity of gas equal to the CDQ, then the daily quantity Buyer shall be obligated to purchase each year thereafter shall be reduced by such average daily amount by which Seller was unable to deliver the CDQ, unless in a subsequent year a lesser quantity is so established, and thereupon each time a lesser quantity is so established then such lesser quantity shall be the quantity of gas Buyer shall be obligated to purchase each year thereafter during the term of this agreement.

If the above provided volumes are increased by mutual agreement, Seller and Buyer shall execute a new Service Agreement including the increased volume.

Article 2 — Term:

This Agreement shall become effective upon the execution hereof and shall continue in full force and effect for an initial term of twenty (20) years from the date of first delivery of gas hereunder to Buyer.

The period of time to be covered by any superseding Service Agreement between Seller and Buyer providing for an increased CDQ shall be determined by agreement between such parties, subject to the right of either party to require that the term of such superseding Service Agreement shall be for twenty (20) years from the date of first delivery of gas thereunder.

Article 3 — Rate Schedules:

3.1 Buyer shall pay Seller for all services rendered hereunder and for the availability of such service under Seller's Rate Schedule CDQ-3 as filed with the Federal Power Commission and as the same may be hereinafter revised or changed.

This Agreement in all respects shall be and remain subject to the applicable provisions of the said Rate Schedule and of the General Terms and Conditions of Seller on file with the Federal Power Commission, all of which are by this reference made a part hereof.

3.2 Seller shall have the right from time to time to increase or decrease the rates by the filing of new rate schedules or to change the form of the applicable rate schedule or rate schedules and to take such other and further action with respect thereto as Seller is legally permitted or required to do, and Buyer shall have the right to oppose any of the foregoing and to request reduction in rates to the extent that Buyer is legally permitted or required to do.

Article 4 — Measurement Pressure:

The average absolute atmospheric pressure which shall be used to compute the quantities of gas delivered shall be 13.2 pounds per square inch.

Article 5 — Pressure:

Seller shall deliver gas into Buyer's 26-inch Transwestern to Blackwell pipeline at such pressure as is required, but not in excess of 700 psig.

Article 6 — Points of Delivery:

The point of delivery of natural gas hereunder shall be at a point of interconnection of Seller's and Buyer's facilities in Section 80, Block 42, H&TC RR Survey, Hemphill County, Texas.

Article 7 — Notices:

Notices to either party shall be sent by United States mail or Western Union telegram addressed as follows:

(a) Transwestern Pipeline Company
Post Office Box 2521
Houston, Texas 77001

(b) Cities Service Gas Company
Post Office Box 25128
Oklahoma City, Oklahoma 73125

IN WITNESS WHEREOF, the parties have caused this agreement to be executed by their duly authorized officers and attested to by their Secretaries or Assistant Secretaries on this ..... day of July, 1971:

TRANSWESTERN PIPELINE COMPANY

ATTEST:

By /s/ I. DAVID BUFKIN
Vice President

/s/ E. N. HOWARD
Assistant Secretary

CITIES SERVICE GAS COMPANY

ATTEST:

By /s/ RUSSELL W. HOFSESS
Vice President

/s/ F. W. HARRIGER, JR.
Assistant Secretary

85-1213

FILED
JAN 21 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-.....

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, et al.,

Respondents.

APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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APPENDIX A

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 84-1358

WISCONSIN GAS COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT
MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CLIFORNIA,
EL PASO NATURAL GAS COMPANY,
PEOPLES GAS LIGHT AND COKE COMPANY,
PUBLIC SERVICE COMMISSION OF WISCONSIN,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
COLUMBIA GAS TRANSMISSION CORPORATION,
STATE OF MICHIGAN, et al.,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
CHATTANOOGA GAS COMPANY,
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK,
NORTHWEST ENERGY COMPANY, INTERVENORS

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

No. 84-1359

ANR PIPELINE COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
COLORADO INTERSTATE GAS COMPANY,
PEOPLES GAS LIGHT AND COKE COMPANY,
PUBLIC SERVICE COMMISSION OF WISCONSIN,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
COLUMBIA GAS TRANSMISSION CORPORATION,
STATE OF MICHIGAN, et al.,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
CHATTANOOGA GAS COMPANY,
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK, INTERVENORS

No. 84-1360

GREAT LAKES GAS TRANSMISSION COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,

PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
TRANSCANADA PIPELINES LIMITED,
PUBLIC SERVICE COMMISSION OF WISCONSIN,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
COLUMBIA GAS TRANSMISSION CORPORATION,
STATE OF MICHIGAN, et al.,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1364

TRANSWESTERN PIPELINE COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PUBLIC SERVICE COMMISSION OF WISCONSIN,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
COLUMBIA GAS TRANSMISSION CORPORATION,
STATE OF MICHIGAN, et al.,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,

PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1407

MIDWESTERN GAS TRANSMISSION COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
PEOPLES GAS LIGHT AND COKE COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1408

TENNESSEE GAS PIPELINE COMPANY
. a Division of Tenneco Inc., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,

CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
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PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
PEOPLES GAS LIGHT AND COKE COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1413

CITY GAS COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
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BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1414

MADISON GAS & ELECTRIC COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1415

WISCONSIN POWER & LIGHT COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,

MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1416

WISCONSIN NATURAL GAS COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1417

WISCONSIN POWER & LIGHT COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1418

WISCONSIN PUBLIC SERVICE CORPORATION, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,

PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1433

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN GAS UTILITIES COMPANY,
STATE OF MICHIGAN, et al.,
MICHIGAN CONSOLIDATED GAS COMPANY,
CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1434

TRUNKLINE GAS COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN GAS UTILITIES COMPANY,
STATE OF MICHIGAN, et al.,
MICHIGAN CONSOLIDATED GAS COMPANY,
CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1441

MIGC, INC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1446

TEXAS EASTERN TRANSMISSION CORPORATION, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1463

ARKANSAS LOUISIANA GAS COMPANY,
a Division of Arkla, Inc., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY, INTERVENORS

No. 84-1470

TRANSCONTINENTAL GAS PILE LINE CORPORATION,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PAN-ALBERTA GAS LTD., et al.,
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK,
PUBLIC SERVICE ELECTRIC AND GAS COMPANY,
KANSAS STATE CORPORATION COMMISSION,
CONSOLIDATED GAS TRANSMISSION CORPORATION,
WASHINGTON GAS LIGHT COMPANY, INTERVENORS

No. 84-1474

ALGONQUIN GAS TRANSMISSION COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY, INTERVENORS

No. 84-1487

TEXAS GAS TRANSMISSION CORPORATION, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al.,
NORTHERN ILLINOIS GAS COMPANY,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
INTERVENORS

No. 84-1489

PACIFIC INTERSTATE OFFSHORE COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

CONSUMERS POWER COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY,
PACIFIC LIGHTING SUPPLY COMPANY, et al.,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1490

CASCADE NATURAL GAS CORPORATION,
NORTHWEST NATURAL GAS COMPANY,
WASHINGTON NATURAL GAS COMPANY, PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al.,
NORTHERN ILLINOIS GAS COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY, INTERVENORS

No. 84-1556

ARKANSAS LOUISIANA GAS COMPANY,
a division of Arkla, Inc., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PACIFIC GAS AND ELECTRIC COMPANY, et al., INTERVENORS

No. 84-1580

TRANSWESTERN PIPELINE COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1623

MIGC, INC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

No. 85-1015

ARKANSAS LOUISIANA GAS COMPANY,
a division of Arkla, Inc., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

Petitions for Review of Orders
of the Federal Energy Regulatory Commission

Argued April 2, 1985

Decided August 20, 1985

Raymond N. Shibley, with whom *Patrick J. Whittle* was on the brief, for Panhandle Eastern Pipe Line Co. and Trunkline Gas Co., petitioners in Nos. 84-1433 & 84-1434, and intervenors in Nos. 84-1358, 84-1359, 84-1360, 84-1364, 84-1407, 84-1408, 84-1413, 84-1414, 84-1415, 84-1416, 84-1417, and 84-1418.

Platt W. Davis, III, for Arkansas Louisiana Gas Co., petitioner in Nos. 84-1463, 84-1556, and 85-1015.

Bruce F. Kiely, with whom *Catherine C. Wakelyn* was on the brief, for Wisconsin Gas Co., *et al.,* petitioners in Nos. 84-1358, 84-1413, 84-1414, 84-1415, 84-1416, 84-1417, and 84-1418.

James T. McManus, with whom *Dale A. Wright, Harold L. Talisman, Michael R. Waller,* and *Terence J. Collins* were on the brief, for Midwestern Gas Transmission Co. and Tennessee Gas Pipeline Co., petitioners in Nos. 84-1407 and 84-1408. *Gregory Grady* also entered an appearance for Midwestern Gas Transmission Co. in No. 84-1407.

James D. McKinney, Jr., with whom *William R. Mapes, Jr.,* and *Narinder J. S. Kathuria* were on the brief, for Great Lakes Gas Transmission Co., petitioner in No. 84-1360.

James W. McCartney and *Judy M. Johnson* were on the briefs for Transwestern Pipeline Co., petitioner in Nos. 84-1364 and 84-1580, and Texas Eastern Transmission Corp., petitioner

in No. 84-1446. *David T. Andril, Carol A. White, Richard C. Alsup,* and *Cheryl M. Foley* were also on the brief for petitioner Transwestern Pipeline Co., and *Bolivar C. Andrews* was on the brief for petitioner Texas Eastern Transmission Corp.

Thomas D. Clarke and *Glen J. Sullivan* were on the brief for Pacific Interstate Offshore Co., petitioner in No. 84-1489.

Michael B. Silva, Robert W. Best, Christopher T. Boland, John F. Harrington, and *William A. Williams* were on the brief for Texas Gas Transmission Corp., petitioner in No. 84-1487. *Robert W. Perdue* also entered an appearance for Texas Gas Transmission Corp.

Thomas F. Ryan, Jr., Robert G. Hardy, and *Michael J. Fremuth* were on the brief for Transcontinental Gas Pipe Line Corp., petitioner in No. 84-1470, and intervenor in Nos. 84-1358, 84-1359, 84-1360, 84-1364, 84-1407, 84-1408, 84-1413, 84-1414, 84-1415, 84-1416, 84-1417, and 84-1418.

David L. Huard, Norman A. Pedersen, Roger B. Coven, and *Rachelle B. Chong* were on the brief for MIGC, Inc., petitioner in Nos. 84-1441 and 84-1623.

John T. Ketcham and *Joseph O. Fryxell* were on the briefs for Algonquin Gas Transmission Co., petitioner in No. 84-1474, and Cascade Natural Gas Corp., *et al.,* petitioners in No. 84-1490. *Robert A. Nelson, Jr.,* was also on the joint brief for petitioners in No. 84-1490. *Ted P. Gerarden* also entered an appearance for Algonquin Gas Transmission Co. in No. 84-1474.

William W. Brackett, Daniel F. Collins, Terry O. Vogel, and *Richard W. Miller, Jr.,* were on the brief for ANR Pipeline Co., petitioner in No. 84-1359.

Ernest C. Baynard, III, Deputy General Counsel, Federal Energy Regulatory Commission, whith whom *Jerome M. Feit,* Solicitor, Federal Energy Regulatory Commission, and *A. Karen Hill,* Counsel, Federal Energy Regulatory Commission, were on

the brief, for respondent. *Barbara J. Weller*, Counsel, Federal Energy Regulatory Commission, also entered an appearance for respondent.

Richard A. Solomon for joint intervenors in Nos. 84-1358, *et al. David E. Blabey*, *David D'Alessandro*, and *Richard Solomon* also entered appearances for intervenor Public Service Commission of the State of New York.

Michael B. Day, with whom *J. Calvin Simpson* was on the brief, for intervenor Public Utilities Commission of the State of California in Nos. 84-1358, 84-1359, 84-1360, 84-1364, 84-1407, 84-1408, 84-1413, 84-1414, 84-1415, 84-1416, 84-1417, and 84-1418.

Jeffrey M. Petrash, with whom *James H. Holt*, *Paul W. Mallory*, and *Mary Baluss* were on the joint brief, for intervenors Inter-City Gas Corp., Michigan Consolidated Gas Co., and Natural Gas Pipeline Co. *Mr. Petrash*, *Mr. Holt*, *Mr. Mallory*, *William Warfield Ross*, and *Daniel L. Koffsky* were also on the brief for intervenors American Iron & Steel Institute, *et al. Toni K. Allen*, *Mr. Ross*, and *Mr. Koffsky* entered appearances for intervenor Consumers Power Co. *Paul E. Goldstein* also entered an appearance for intervenor Natural Gas Pipeline Co. *George B. Mickum, III*, also entered an appearance for intervenor Inter-City Gas Corp.

Thomas M. Patrick, with whom *James Hinchliff* and *Karen Cargill* were on the brief, for intervenor Peoples Gas Light & Coke Co. *Richard E. Terry* also entered an appearance for Peoples Gas Light & Coke Co.

George W. McHenry, Jr., and *John R. Staffier* were on the brief for intervenors Pan-Alberta Gas, Ltd. and Foothills Pipe Lines (Yukon) Ltd. *John H. Burnes, Jr.*, also entered an appearance for Pan-Alberta Gas, Ltd.

William M. Lange and *Jeffrey M. Goldsmith* were on the brief for intervenor Colorado Interstate Gas Co. *Nancy A. White* also entered an appearance for Colorado Interstate Gas Co.

E. R. Island and *Michael D. Gayda* were on the brief for intervenors Pacific Lighting Gas Supply Co. and Southern California Gas Co.

Steven M. Schur was on the brief for intervenor Public Service Commission of Wisconsin.

Joseph C. Bell and *Jeffrey Spring* were on the brief for Citizens Energy Corp., *amicus curiae*, urging affirmance in No. 84-1358.

David I. Bloom, Lynn G. Kamarck, and *Wendell H. Adair, Jr.*, entered appearances for intervenor Northern Illinois Gas Co.

Philip J. Mause entered an appearance for intervenor Public Service Commission of Wisconsin.

Stephen J. Small and *Richard L. Gottlieb* entered appearances for intervenor Columbia Gas Transmission Corp.

Donald J. MacIver, Jr., Richard Owen Baish, Scott D. Fobes, C. Frank Reifsnyder, and *Richard C. Green* entered appearances for intervenor El Paso Natural Gas Co.

Edward J. Grenier, Jr., and *Glen S. Howard* entered appearances for intervenor Process Gas Consumers Group, *et al.*

Richard M. Merriman, John R. Schaefgen, Jr., and *Stephen L. Huntoon* entered appearances for intervenor Michigan Gas Utilities Co.

Peter W. Hanschen, Steven F. Greenwald, and *J. Michael Reidenbach* entered appearances for intervenor Pacific Gas and Electric Co., *et al.*

Michael W. Hall and *Gary E. Guy* entered appearances for intervenor Brooklyn Union Gas Co.

Thomas F. Ryan, Jr., Robert G. Hardy, and *Michael J. Fremuth* entered appearances for intervenor Trancontinental Gas Pipe Line Corp.

Louis J. Caruso, R. Philip Brown, Don L. Keskey, Ronald D. Eastman, and *Lynda S. Mounts* entered appearances for intervenors State of Michigan, *et al.*

John B. Rudolph entered an appearance for intervenor Northwest Energy Co.

Paul H. Keck and *Douglas L. Beresford* entered appearances for intervenor Transcanada Pipelines, Ltd.

C. Edward Peterson entered an appearance for intervenor Kansas State Corp. Commission.

James R. Lacey entered an appearance for intervenor Public Service Electric and Gas Co.

Lewis Carroll entered an appearance for intervenor Washington Gas Light Co.

James L. Blasiak entered an appearance for intervenor Consolidated Gas Transmission Corp.

Before TAMM, MIKVA, and STARR, *Circuit Judges.*

Opinion for the court filed by *Circuit Judge* TAMM.

TAMM, *Circuit Judge:* Petitioners sell natural gas under contracts, tariffs, and certificates approved by the Federal Energy Regulatory Commission (the Commission). These contracts and tariffs often contain minimum commodity bills (or minimum bills) and minimum take provisions. A minimum commodity bill requires a pipeline customer to pay for a minimum volume of gas, whether or not the customer purchases that amount of gas. A minimum take provision requires a pipeline customer to take physically a certain amount of gas and does not give the customer the option to pay for gas not taken. Petitioners in these consolidated cases challenge Commission Order No. 380, which declares inoperative minimum bills to the extent such provisions

enable pipelines to recover variable costs for gas not purchased by its customers, and Commission Order No. 380-C, which affirms the application of Order No. 380 to minimum take provisions.[1] For the reasons given below, we affirm the Commission's orders in all respects, except one. We find that the Commission's decision, articulated in Order 380-A, that downstream pipelines cannot include in their minimum commodity bills certain fixed costs that their respective pipeline suppliers are permitted to include in their minimum bills is not based on reasoned decisionmaking, and we therefore remand that issue to the Commission for proceedings consistent with this opinion.

I. Background

Interstate pipelines ordinarily use a two-part rate consisting of a "commodity charge" and a "demand charge." All customers pay a commodity charge, which is levied upon each unit of gas sold. Through the commodity charge, pipelines recover all the variable costs of providing service and between one-half and seventy-five percent of the fixed costs.[2] Pipelines recover the

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[1] *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, Order No. 380, 27 FERC ¶61,318; Order No. 380-A, 28 FERC ¶61,175; Order No. 380-C, 29 FERC ¶61,077; and Order No. 380-D, 29 FERC ¶61,332 (1984).

In Order No. 380-A, the Commission addressed arguments raised on rehearing and stayed the effect of the rule on minimum take tariff provisions pending further comments. In Order No. 380-B, the Commission denied rehearing of Order No. 380-A. In Order No. 380-C, the Commission discussed comments on the minimum take issue and decided that its rule should also nullify those tariff provisions. In Order No. 380-D, the Commission denied rehearing of Order No. 380-C.

[2] One reason for including some of the fixed costs in the "commodity" charge is that some customers, called "interruptible customers," do not pay a "demand" charge. These customers, unlike so-called "firm customers," are not contractually entitled to demand specific amounts of natural gas. Interruptible customers may purchase only the gas not demanded by firm customers and typically pay only a commodity charge for amounts actually taken.

remainder of the fixed costs through the "demand charge," which is levied upon those customers who have a contractual entitlement to receive a specified amount of gas. The demand charge is not levied upon each unit of gas sold, but rather is a fixed sum, assessed in proportion to the maximum quantity of gas the customer is entitled to demand under the contract. The demand charge thus recoups some portion of fixed costs incurred by the pipeline in providing a transmission mechanism of sufficient capacity to meet the customer's peak-load minimum entitlement.

Minimum commodity bills (or minimum bills) developed as an exception to the general rule that a commodity charge is levied only upon gas actually taken by the customer. The minimum bill requires a customer to pay the pipeline for a minimum volume of gas each month—typically from sixty-six to ninety percent of the amount of gas the customer is entitled to demand under the contract—whether or not the customer actually takes that amount of gas. Minimum take provisions do not allow customers to pay for gas not taken, but instead require customers to physically take the specified amount of gas.[3]

Minimum bills are generally imposed upon "partial requirements" customers, that is, customers who have more than one pipeline supplier. Unlike so-called "full requirements" or "captive" customers, partial requirements customers' geographic locations enable them to "swing" from one supplier to another to purchase the cheapest available gas. By requiring partial requirements customers to take or pay for a specified amount of gas, minimum bills limit the partial requirements customers' ability to swing from one pipeline supplier to another pipeline supplier.

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[3] Unless otherwise specified, the term "minimum bill" refers to both minimum commodity bills and minimum take provisions.

The Commission traditionally has given three justifications for minimum bills.[4] First, minimum bills operate like the demand charge to recover fixed costs in proportion to a customer's peak needs, rather than the customer's actual take of gas. Second, minimum bills allocate fixed costs equitably among partial requirements and full requirements customers. Partial requirements customers take gas from more than one pipeline and can therefore drastically reduce their takes to capitalize on a cheaper source of gas. Full requirements customers take all of their gas from a single pipeline and are therefore unable to "swing" their purchases to other suppliers. Without a minimum bill, the full requirements customer could pay a disproportionate share of the fixed costs. Although the partial requirements customer pays for some fixed costs under the demand charge—computed on the basis of the customer's entitlement and not on what the customer takes—the partial requirements customer can avoid that portion of the fixed costs collected through the commodity charge by swinging to an alternative source.

Finally, minimum bills enable pipelines to cover their own "take-or-pay" obligatons to gas producers. Take-or-pay contracts govern wellhead sales between producers and pipelines. Like minimum bills, under take-or-pay contracts a pipeline must take or, if not take, pay for, a minimum amount of gas.[5] The pipeline must contract with the producer for a quantity of gas sufficient to fulfill the pipeline's obligation to deliver to its customers the contract demand amount. If a partial requirements customer makes an unexpected swing off of the system, the pipeline may be unable to sell the gas it is obligated to purchase from the producer. Associated take-or-pay liabilities, if "prudently"

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[4] *See generally* Atlantic Seaboard Corp. v. FPC, 404 F.2d 1268 (D.C. Cir. 1968); Lynchburg Gas Co. v. FPC, 336 F.2d 942 (D.C. Cir. 1964).

[5] The significant differences between take-or-pay contracts and minimum bills are discussed *infra* p. 40 ("Harm to Pipelines—The Take-or-Pay Issue").

incurred, become a fixed cost on the system and can be passed on to remaining customers in the form of increased rates. By requiring partial requirements customers to purchase a minimum amount of gas, the minimum bill reduces a pipeline's exposure to take-or-pay liabilities and hence protects full requirements customers from bearing a disproportionate share of the pipeline's fixed costs.

Significantly, the justifications traditionally given for the minimum bill focus upon the allocation of *fixed* costs among pipeline customers. Since variable costs traditionally represented a relatively small proportion of the total minimum commodity bill, recovery of variable costs through the minimum bill was generally incidental to the recovery of fixed costs. Moreover, until the late 1970's, demand for natural gas exceeded supply; consequently, pipeline customers seldom paid for gas that they would not have taken in the absence of a minimum bill provision.

Because of radical changes in the natural gas industry over the past several years, minimum bills have had an increasingly severe impact upon the price of natural gas and the allocation of variable costs among pipeline consumers. In 1978, Congress passed the Natural Gas Policy Act (NGPA), 15 U.S.C. §§3301 *et seq.* (1982), which removed regulations that had kept wellhead prices below market value. The statute had the intended effect of encouraging production. The simultaneous drop in oil prices and a severe recession, however, drastically reduced demand for natural gas. The net result of these converging factors was to convert the gas supply shortage of 1977-78 to the gas supply surplus of 1982-85.

Natural gas prices, however, did not fall during this nationwide glut. Instead, the price of gas remained high because minimum bills forced customers to purchase gas from particular pipelines even if cheaper supplies were available elsewhere. At

the same time, the minimum bill's salutory effect upon the distribution of fixed costs among partial and full requirements customers diminished as fixed costs became an increasingly smaller percentage of minimum bills. Purchased gas cost—the primary variable cost—steadily rose from forty percent to over seventy-five percent of the pipeline's delivered cost. *See* Order No. 380 at 11, Joint Appendix (J.A.) at 802.

In response to concerns raised by parties regarding the role of minimum bills in this anomalous situation, the Commission announced in 1983 its intention to eliminate minimum bills from a pipeline's tariff to the extent that these provisions permitted the recovery of variable costs. Notice of Proposed Rulemaking, J.A. at 1. After receiving comments from over ninety-five interested parties, the Commission determined that minimum bills had two negative effects upon the natural gas market:

> First, minimum commodity bills have become a vehicle by which enormous purchased gas "costs" can be collected even if the pipeline never actually incurs such costs. Second, minimum commodity bills have become a major obstacle to the transmittal of clear market signals from the burner tip back to the wellhead.

Order No. 380 at 14, J.A. at 805. Accordingly, the Commission held that the collection of variable costs through a minimum bill represented an "unjust and unreasonable" rate under sections 4 and 5 of the Natural Gas Act (NGA). After taking additional comments, the Commission in Order No. 380-C extended this prohibition to minimum take provisions.

Order No. 380 is limited in two critical respects. First, the order does not affect the recovery of *fixed* costs through the minimum bill. Partial requirements customers, therefore, remain obligated to pay the fixed costs attributable to their contract entitlement amount: under the Commission's decision, these costs can be recovered through the demand charge (unrelated to the minimum bill) and through the fixed-cost component of the

minumum bill.[6] Second, although take-or-pay contracts between pipelines and gas producers superficially resemble the minimum bills between pipelines and their purchasers, the Commission has chosen not to prohibit variable-cost components in take-or-pay clauses at this time. Thus, while gas customers are relieved of the burden of purchasing minimum amounts of gas, pipelines must still honor commitments to gas producers to take, or pay for, a specified amount of gas.

Few elements of the Commission's rulemaking have escaped the collective challenge of the many parties before this court. Rather than discuss the challenges separately, we group the

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[6] A simple example may illustrate the impact of the regulation upon a pipeline's tariff. Suppose a customer's demand charge, set in ratemaking, is a flat $1,000,000 a month. Pursuant to the commodity charge, the pipeline charges $4.00 per million cubic feet (mcf) of gas taken. Of the $4.00, $3.50 is for purchased gas costs, $.47 is for fixed costs, and $.03 is for non-gas variable costs. In a given month, the customer takes 2.5 million mcf, but the tariff provides for a minimum bill requirement of 3 million mcf. Before the implementation of the Commission's rule, the customer's bill would be computed in the following fashion:

Demand charge:	$ 1,000,000
Commodity charge:	
$4.00 x 3 million mcf	12,000,000
Total	$13,000,000

Under the Commission's rule, the minimum bill could not be used to recover variable costs, and the tariff would be computed in the following fashion:

Demand charge:	$ 1,000,000
Commodity charge:	
$3.50 (purchase gas costs) x 2.5 million mcf	8,750,000
.03 (non-gas variable costs) x 2.5 million mcf	75,000
.47 (fixed costs) x 3.0 million mcf	1,410,000
	$10,235,000
Total:	$11,235,000

arguments around three aspects of the Commission's decision. First, we address the Commission's statutory authority to eliminate variable cost recovery through minimum bills. We then consider the substantive validity of the rule, that is, whether it is based on substantial evidence and is otherwise a reasonable exercise of agency authority. Finally, we address petitioners' various challenges to the procedures employed by the Commission.[7]

II. Statutory Authority.

A. *Statutory Framework*

Sections 4 and 5 of the Natural Gas Act empower the Commission to regulate rates, charges, and practices of natural gas companies under its jurisdiction. Section 4(c) provides that rates charged by natural gas companies "shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." 15 U.S.C. § 717c(a), Section 5(a), the primary basis for the Commission's authority to promulgate the challenged orders, empowers the Commission to examine rates to determine whether they comply with the section 4 standard:

> Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. . . .

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[7] Arguments raised in this appeal that are not expressly addressed have been considered and determined to be without merit.

15 U.S.C. § 717d(a). As this court held in *American Public Gas Association* v. *FPC*, 567 F.2d 1016, 1064-67 (D.C. Cir. 1977), the Commission is empowered to exercise its section 5(a) authority by rule,[8] Finally, section 16 of the Natural Gas Act, 15 U.S.C. § 717o, authorizes the Commission to "perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of the [Act]."

B. *Challenges to the Commission's Statutory Authority*

Although petitioners launch a barrage of attacks upon the Commission's authority to issue Order No. 380, only two claims warrant textual discussion.[9] First, petitioners Transcontinental

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[8] Congress ratified this holding in the Department of Energy Organization Act, 42 U.S.C. § 7173(c) (1982): "Any function . . . which relates to the establishment of rates and charges under the . . . Natural Gas Act . . ., may be conducted by rulemaking procedures." Petitioners' claims that the Commission is without the power to exercise section 5 authority by generic rulemaking are therefore completely without merit. Petitioners' claims that the Commission has abused its discretion by proceeding by rule and not through case-by-case adjudication are discussed *infra* p. 54 ("Choice Between Rulemaking and Adjudication").

[9] We reject petitioners' contentions that the elimination of minimum bills effects an unlawful revocation of certificated service authorized under section 7 of the NGA. Section 7, which vests in the Commission control over the conditions under which gas may initially be dedicated to public use, does not guarantee that the initial terms of that service will never change. *See* Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 389 (1959). Even assuming *arguendo* that the Commission has no authority to amend or revoke certificated service in a section 5 proceeding, the elimination of minimum bills has no effect on the pipeline's *authorized* service. The Order merely addresses the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5.

Petitioners also contend that the Order lawfully alters the terms of existing contracts by destroying the mutuality of obligations between the pipeline and the partial requirements customer. This claim is frivolous. Fixed costs are still recoverable from partial requirements customers through the demand charges and through the fixed cost portions of the minimum bill. At any rate, section 5

Gas Pipe Line Corporation (Transco) and ANR Pipeline Company (ANR) contend that the commission was unlawfully abrogated settlement agreements to which the Commission is a party. Second, petitioner Great Lakes Gas Transmission Company argues that Order No. 380 is in excess of the Commission's authority because it is inconsistent with its import authorization approved by the Economic Regulatory Commission pursuant to section 3 of the Natural Gas Act.

1. Abrogation of Settlement Agreements

Transco and ANR each contend that the Commission exceeded its statutory authority by abrogating settlement agreements to which the Commission was a party. The Commission contends in response that it cannot limit by settlement either its statutory authority under section 5 to investigate the reasonableness of tariffs or its statutory obligation to change prospectively tariffs it finds unjust or unreasonable.

We find that Order No. 380 does not violate any terms of either Transco's or ANR's settlement. We therefore do not reach the issue of whether the Commission has the statutory authority to abrogate settlement agreements to which it is a party through a generic section 5 rulemaking.

a. Transco

Prior to the initiation of the Order No. 380 rulemaking, Transco, its customers, and the Commission staff agreed in a settlement of Transco's rate proceeding to reserve for determination at an adjudicative hearing the issue of the design and cost

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gives the Commission authority to alter terms of any existing contract found to be "unjust" or "unreasonable." 15 U.S.C. § 717d(a). *See also* Permian Basin Area Rate Cases, 390 U.S. 747, 783-84 (1968) (rejecting gas producers' argument that Commission action might destroy the contracts in which unjust price escalator clauses were found, holding that "the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests").

components of Transco's minimum bill charge. After the adjudicative hearing, but before the Administrative Law Judge (ALJ) rendered his final decision, the Commission issued Order No. 380 nullifying minimum bills to the extent that they recover variable costs in the commodity charge. The ALJ found that Order No. 380 governed disposition of the issue and held that Transco could not revover variable costs in its minimum bill. Transco contends that the Commission abrogated the settlement agreement by taking from the ALJ the power to render a decision based upon Transco's particular need for a minimum bill.

We disagree. The settlement agreement reserved the minimum bill issue for determination but did not mandate any particular resolution. Transco received what the settlement promised—a hearing before an ALJ. The ALJ's conclusion, based on Order No. 380, that Transco could not recover variable costs in its minimum bill does not violate any of Transco's rights under the settlement agreement. Had the parties intended to immunize Transco's minimum bill from the general impact of an industry-wide rulemaking, they could have easily so provided in the terms of the agreement. We refuse to read any such broad-ranging intent into the simple agreement to defer resolution of the dispute and, therefore, conclude that Order No. 380 does not abrogate the terms of the settlement agreement.

b. ANR and WDG

In 1982 Michigan Consolidated Gas Company (Mich-Con) advised ANR that it would fall roughly $200 million short of the minimum bill level prescribed in the tariff between ANR and MichCon. In the spring and summer of 1982, MichCon's minimum bill became an issue in ANR's general rate increase application proceeding pending before the Commission After

extensive negotiations, the parties (MichCon, ANR, and Wisconsin Distributors Group (WDG)[10] agreed to some changes in the minimum bill but concluded that further proceedings were necessary to finally resolve other contested minimum bill issues. Accordingly, the parties entered into the following agreement:

> All issues relating to cost allocation, classification and rate design *will be set for hearing in Docket No. RP82-80*. The Commission's decision therein pursuant to such hearings relative to such issues will be effective, prospectively only, on the first November 1 following the date of a Final Commission Order issued in such case; provided, however, that if a Final Commission Order is issued between October 1 and November 1 of the same year, it shall be implemented on November 1 of the next succeeding year.

Brief for ANR at 28 (emphasis added). The Commission approved this agreement on February 10, 1983. After thirteen months of further negotiations, the parties still had not settled the minimum bill issues, and, on January 19, 1984, the Commission approved another settlement agreement which, like the agreement quoted above, deferred resolution of the minimum bill issues.

Meanwhile, on August 25, 1983, the Commission issued its notice of proposed rulemaking for Order No. 380. ANR and WDG filed comments in opposition, stating their belief that the Commission did not have the statutory authority to determine by rulemaking the minimum bill issues subject to the settlement agreement. In Order No. 380, the Commission addressed these comments but concluded that the settlement agreement could not be binding insofar as it "reflects a provision found to be unjust and unreasonable." J.A. at 841.

MichCon contends that even if the Commission lacks the statutory authority to abrogate the settlement agreement, Order

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[10] Wisconsin Distributors Group consists of a number of ANR's pipeline customers.

No. 380 does not, in fact, violate the terms of the settlement agreement. We agree. The reservation in the settlement agreement does not, as ANR and WDG contend, mandate that the minimum bill issue be resolved only in ANR's individual rate case. The settlement merely provides that the issue "be set for hearing in Docket No. RP82-80"; it does not say, as petitioners believe, that "the parties . . . expressly agree that no change in ANR's minimum bill would be allowed until after hearing and final Commission order." Brief for WDG at 8. The settlement merely defers resolution of the minimum bill issue. Again, had the parties to the settlement agreement intended to exempt ANR's minimum bill from the ongoing general rulemaking, they could have easily so provided. As it is written, however, the agreement neither binds the commission to resolve the issues in ANR's ratemaking proceeding nor exempts ANR's minimum bill provisions from the general rulemaking in progress. We conclude, therefore, that by issuing Order No. 380 the Commission did not violate the terms of the settlement agreement.

2. Authority to Regulate Imported Gas

Originally, the Federal Power Commission regulated the import and export of natural gas pursuant to section 3 of the NGA.[11] Congress in 1977 transferred the functions of the Federal Power Commission to the Department of Energy (DOE) but did not specify which entity within DOE would be responsible for regulating the import and export of natural gas.[12] The Secretary of Energy issued an order delegating shared regulatory authority over imported gas to the Economic Regulatory Administration (ERA) and the Commission. The Secretary granted ERA authority to determine in what instances the

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[11] 15 U.S.C. § 717(b) provides in relevant part: "[N]o person shall export . . . or import any natural gas . . . without first having secured an order of the Commission authorizing it to do so."

[12] *See* PUB. L. No. 95-91, 91 Stat. 565 (Aug. 4, 1977), *codified at* 42 U.S.C. §§ 7151, 7172.

importation of natural gas is in the public interest.[13] The Secretary gave the Commission authority, however, to regulate imported gas as it moves through interstate commerce.[14] Confusion over the respective authority of the two agencies led the Secretary to issue new policy guidelines on February 17, 1984. These new regulations provide:

> The FERC . . . maintains its responsibilities for exercising sections 4, 5, and 7 authority under the Natural Gas Act over gas authorized for import by the Administrator. Gas authorized for importation is subject to the FERC's review of issues pertaining to siting, construction, and operation of pipeline facilities, and to the rates proposed to be charged for the interstate transportation and sale of the gas. The FERC review, in effect, will address the regulatory matters relevant to the imported gas upon its entry into the United States and as it flows through domestic gas transportation systems. *In its regulatory decisions on a gas supply authorized for importation, the Commission will adopt the terms and conditions attached by the ERA Administrator to the import authorization, thus acting consistently with the determinations made by the Administrator and the policy considerations reflected in the authorization.*

New Policy Guidelines and Delegation Orders on the Regulation of Imported Natural Gas, 49 Fed. Reg. 6684, 6689 (1984) (emphasis added) (hereinafter "Delegation Orders"). In sum, the Commission is statutorily obligated under sections 4 and 5 of the Act to declare unlawful rates it finds unjust and unreasonable. Pursuant to the section 3 power delegated to it by the Secretary, the Commission is empowered to exercise its section 4 and 5 powers over imported gas. The only limit placed upon this authority is that the Commission cannot, consistent with the Delegation Orders, take actions inconsistent with the terms, conditions, or policy considerations reflected in the ERA's section 3 import authorization.

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[13] Delegation Order No. 0204-54, 44 Fed. Reg. 56,735.

[14] *Id.*

Petitioner Great Lakes imports natural gas purchased from its sole supplier, TransCanada Pipelines Ltd., pursuant to a section 3 import authorization. The authorization approves a contract between Great Lakes and TransCanada, which contains take-or-pay provisions. Great Lakes contends that Order No. 380 is inconsistent with the approved take-or-pay clauses because, without variable cost recovery through minimum bills, Great Lakes will be unable to recoup any take-or-pay liability from its partial requirements customers. This claim is without merit. First, Order No. 380 expressly does not alter the terms or conditions of the contracts between Great Lakes and its Canadian supplier. Similarly, the import authorization is unrelated to the object of Order No. 380—the contractual relationship between Great Lakes and its customers.

Second, that Order No. 380 may render the contractual provisions approved by the ERA more burdensome does not mean that the Order is inconsistent with the terms of the import authorization. Any action taken by the Commission pursuant to its delegated authority under section 3 is bound to have an impact upon the pipeline selling imported gas, which, in turn, will have an impact upon the pipeline's relationship with its foreign supplier. For the Commission's power under section 3 to have any meaning, however, it must extend to actions such as those taken here, which may indirectly affect the import authorization. Here, the impact upon the authorization is trivial; the Commission's action in no way intrudes upon the responsibilities delegated to the ERA. As such, the Commission's decision cannot be deemed inconsistent with the terms or conditions of the authorization, or with any policy considerations underlying the authorization. We therefore hold that by eliminating the minimum bill in Great Lakes' tariff, the Commission has not exceeded its authority to regulate importers of natural gas.

III. Substantial Evidence

A. *The Standard of Review*

The parties devote a substantial part of their briefs to the issue of the proper standard of review of this informal rulemaking under the Natural Gas Act. Some petitioners submit that the court must apply the "substantial evidence" test, which is, in their view, less deferential than the "arbitrary and capricious" test. Some intervenors and the Commission insist that while the Commission's factual determinations must be based on substantial evidence, the Commission's policy decisions should be accorded greater deference under the "arbitrary and capricious" standard.

There is much less to this dispute than meets the eye. Under section 19(b) of the Natural Gas Act, the Commission's findings of fact, if supported by "substantial evidence," shall be conclusive. As we held in *Public Systems* v. *FERC*, 606 F.2d 973, 979 (D.C. Cir. 1979), the "substantial evidence" standard of section 19 applies to notice and comment rulemaking. When applied to such proceedings, however, the substantial evidence test is identical to the familiar arbitrary and capricious standard. *See American Public Gas Association* v. *FPC*, 567 F.2d 1016, 1029 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978).[15] Under this standard, the court requires "the Commission to specify the evidence on which it relied and to explain how that evidence supports the conclusion it reached." *City of Charlottesville* v. *FERC*, 661 F.2d 945, 950 (D.C. Cir. 1981).[16]

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[15] For a detailed discussion of the substantial evidence and arbitrary and capricious tests, see Association of Data Processing Service Organizations, Inc. v. Board of Governors of the Federal Reserve System, 745 F.2d 677 (D.C. Cir. 1984).

[16] For more elaborate discussion of the standard of review of agency actions under the Act, *see generally* Permian Basin Area Rate Case, 390 U.S. 747, 791-92 (1968); West Virginia Public Services Commission v. United States Department of Energy, 681 F.2d 847, 852-53 (D.C. Cir. 1982).

B. *Discussion*

We divide the various challenges to the reasonability of the Commission's rule into two broad groups. First, we consider the evidentiary support for the rule as a whole. Second, we address particular claims unique to several petitioners.

1. Evidentiary Basis for the Rule

Three essential findings underlie the Commission's rule. First, minimum bills allow pipelines to recover for various costs that they do not incur. Second, minimum bills prevent gas purchasers from purchasing the lowest priced gas and hence artificially maintain high gas prices. Third, the benefit of eliminating variable cost recovery through minimum bills outweighs the negative impact such action will have upon pipelines and upon full requirements customers.

a. Prevention of Overrecovery of Variable Costs

The Commission found that to the extent minimum commodity bills permit the recovery of variable costs not incurred, they are unjust and unreasonable under the Natural Gas Act, Order No. 380 at 19, J.A. at 810. Although challenged by a surprising number of petitioners, the factual support for the overrecovery rationale is unassailable. Minimum bills allow pipelines to charge for gas that its customer does not take; if the customer pays for gas not taken, the pipeline recovers for variable costs that it does not incur.

Many pipelines contend that the overrecovery rationale does not apply to their particular circumstances because their customers have never actually paid for gas not taken. Petitioner ANR contends, for example, that the evidence does not support the overrecovery rationale because, in decades of operations, it has never actually collected for gas not taken. This fact is as unastonishing as it is irrelevant. ANR's contention merely reflects the rational choice of its partial requirements customers to take gas that they must pay for rather than pay for gas not

taken. The lynchpin of the Commission's rationale, however, is the *potential* for overrecovery. ANR's challenge, typical of many petitioners' arguments, does nothing to refute the Commission's finding that the rule will be beneficial to the extent that it will prevent even the possibility that pipelines like ANR will recover variable costs for gas not taken.[17]

b. Promotion of Competition

Properly understood, the Commission's overrecovery rationale is inextricably linked to the second purpose of eliminating variable cost recovery through minimum bills—to promote price competition among pipelines. With respect to gas purchasing decisions, partial requirements customers who operate pursuant to a minimum bill have only two options. First, if the gas is either not needed or if less expensive gas is available elsewhere, the customer can pay for the minimum requirement of gas but not take it. For obvious reasons, this rarely happens; but when it does, it can lead to overrecovery by the pipeline. Second, the customer can pay for and take the gas, and, in some instances, either forego a cheaper alternative elsewhere or take gas that it does not need and cannot market. When this second option is chosen, the Commission found, minimum bills operate to artifically maintain high gas prices. The Commission reasoned that if variable cost components in minimum bills are eliminated, partial requirements customers will purchase gas from the cheapest supplier, rather than be forced, under the minimum bill, to

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[17] Several petitioners argued that if the Commission's concern is the possibility of windfall profits, a more finely tailored remedy would be to require pipelines to credit those sums not actually incurred back to customers through a purchased gas cost adjustment filing. The Commission reasonably found, however, that such an accounting is an unacceptable alternative because it would benefit all customers equally, thus overcompensating those who do not incur minimum bill liability and undercompensating those who do. Order No. 380 at 17, J.A. at 808.

purchase the gas regardless of cost. The prospect of losing partial requirements customers to cheaper alternatives will, therefore, force pipelines to become more price competitive.

Petitioners do not seriously challenge the plausibility of the Commission's thesis concerning the anti-competitive effects of minimum bills.[18] Rather, petitioners insist that "mere reliance on an economic theory cannot substitute for substantial record evidence and the articulation of a rational basis for an agency's decision." *Electricity Consumers Resource Council* v. *FERC*, 747 F.2d 1511, 1514 (D.C. Cir. 1984).

As we have repeatedly held, unsupported or abstract allegations of the benefits that will accrue from increased competition cannot substitute for "a conscientious effort to take into account what is known as to past experience and what is reasonably predictable about the future." *American Public Gas Association* v. *FPC*, 567 F.2d 1016, 1037 (D.C. Cir. 1977). Thus, while an agency "is not required to make specific findings of tangible benefit," there must be "ground for reasonable expectation that

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[18] Several petitioners argue that even if the Commission's rationale supports its decision with respect to minimum bills, it cannot support application of the rule to minimum take provisions because "in contrast to minimum bills, there is no amount paid for gas not taken, no receipt of money for costs not incurred, and no argument that the purchaser is paying more than a just and reasonable rate for the gas it purchases." Brief for Arkansas Louisiana Gas Co. (ARKLA) at 24. This argument is without merit. As a practical matter, there is no difference between the two contract provisions because in the case of the minimum bill, customers rarely pay for gas not taken. More importantly, there is no difference between the two types of clauses with respect to the Commission's rationale for the rule; both provisions have the same negative impacts on the natural gas market. Although minimum take provisions do not require customers to pay for gas that they never receive, the provisions, perhaps more so than minimum bills, impede price competition among pipelines. A minimum take customer must physically take a minimum quantity of gas, thereby foregoing a cheaper alternative. Thus, the anticompetitive effects of the minimum take provisions are the same as those of minimum bills, and the Commission's rationale properly applies to both.

competition may have some beneficial impact." *FCC* v. *RCA Communications, Inc.*, 346 U.S. 86, 96,97 (1953).

The Commission has provided abundant evidence that the recovery of variable costs through minimum bill and minimum take clauses prevents customers from shopping for low-cost gas, thereby insulating pipelines from market forces that would otherwise drive gas prices down. The record is replete with comments from customers who have been unable to purchase lower cost gas because of minimum bills and minimum take provisions.[19] Furthermore, the arguments made by petitioners themselves support the Commission's findings. Petitioner ANR, for example, complains that Order No. 380 will allow its largest partial requirements customer, MichCon, to swing to a cheaper supplier. It will indeed—and consequently will save MichCon hundreds of millions of dollars.[20]

The best argument petitioners can muster is that, while the elimination of minimum bills will increase competition, other market imperfections will prevent the Commission's rule from having the intended beneficial impact upon the natural gas market. Petitioners MIGC, Inc. and Arkansas Louisiana Gas Company (ARKLA) contend, for example, that because their large partial requirements customers also purchase gas directly from producers, these customers may swing to purchase *higher* priced gas to avoid additional take-or-pay liability. Yet, it is far from clear that this swing will not result in cheaper gas prices at the "burner tip"—the consumer level of the gas transmission system. Presumably, these customers are obligated to take or

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[19] *See* J.A. at 23, 35-36, 95-97, 164-65, 189-90, 193-94, 212, 299-300, 309-11, 814 n. 28.

[20] Similarly, petitioner Algonquin Gas Transmission Co. asserts that minimum bills should be allowed *because* they insulate pipelines from competition. Brief for Algonquin at 35. Algonquin, like other pipelines, essentially concedes that the rule will have its intended impact of forcing it and other pipelines to be more responsive to market conditions.

pay for the higher priced gas regardless of whether minimum bills are in force. Further, any take-or-pay penalties can be included in the pipeline customer's rates. It would seem, therefore, that elimination of minimum bills will enable the pipeline's customers to avoid take-or-pay penalties and to pass these savings on to the ultimate consumers. More significantly, however, the issue is not whether a particular pipeline will pursue a least-cost purchasing stategy but is instead whether the customer will have the ability to do so. Even if some customers do not pursue such a strategy, the Commission has presented evidence that many customers will, and thus the elimination of minimum bills can reasonably be expected to lower gas costs and spur competition among pipelines.[21] We therefore conclude that the Commission has not merely assumed that competition will have a beneficial impact upon the natural gas market but instead has presented a sensible theory supported by substantial evidence.

c. The Detrimental Impact of Rule 380

Unable to assail the Commission's conclusions that the elimination of minimum bills will remove barriers to competition, petitioners contend that the general benefits of competition do not outweigh the harm that will be visited (1) upon pipelines subject to take-or-pay liabilities with gas producers and (2) upon the full requirements customers of higher priced pipelines.

(1) Harm to Pipelines—The Take-Or-Pay Issue

As explained above, contracts between producers and pipelines often contain take-or-pay clauses, which, like the minimum bill, require a pipeline to take or pay for a specified amount of gas. The petitioners assert that the problems created by take-or-pay contracts with producers are inextricably linked to minimum bills because if their partial requirements customers shift to

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[21] The Commission, therefore, reasonably denied ARKLA's request for a waiver from Rule 380. *See* Order No. 380-A at 60-62, J.A. at 1515-17.

lower cost suppliers, they will be unable to meet their take-or-pay obligations. Petitioners contend that by failing to sumultaneously prohibit take-or-pay clauses, the Commission has engaged in irrational "piecemeal reform" and unduly discriminated against pipelines in favor of producers and purchasers.

The Commission gave considerable attention to the difficult take-or-pay issue but concluded that "there is no clear nexus between a pipeline's annual take-or-pay obligations and its minimum commodity bills to its customers." Order No. 380 at 41, J.A. at 832. As the Commission explained in Order No. 380-A, "[t]his does not mean, however, that the Commission necessarily supports high take-or-pay levels in producer-pipeline contracts. It is simply not essential that the take-or-pay issues be resolved here." Order No. 380-A at 31, J.A. at 1486.

The issue for this court, then, is not whether take-or-pay clauses should be prohibited but is whether the take-or-pay clauses are so inextricably related to minimum bills that simultaneous resolution of the issues is required. We held in *ITT World Communications, Inc.* v. *FCC*, 725 F.2d 732, 754 (D.C. Cir. 1984), that "an agency does not act rationally when it chooses and implements one policy and decides to consider the merits of a potentially inconsistent policy in the very near future." We have also held, however, that review of an agency decision to defer issues must be "pragmatic so as to ensure reasoned decisionmaking while allowing the Commission to cope with rapidly changing circumstances." *Neighborhood TV Co.* v. *FCC*, 742 F.2d 629, 642 (D.C. Cir. 1984). An agency should not be paralyzed by having to decide all relevant issues at the same time. The agency's decision should be upheld unless the agency "abuses[s] this flexibility by failing to consider, in a rulemaking, an issue whose resolution might seriously undercut the . . . rationale for its final action in that rulemaking." *Id.* (citations omitted).

The Commission advanced several reasons for its conclusion that the minimum bill and take-or-pay issues are not inextricably linked. First, petitioners' attempt to characterize the minimum bill as the pipeline's protection against take-or-pay liability is simply incorrect. Possible reductions in purchases by partial requirements customers will not necessarily result in increased pipeline liability under take-or-pay clauses. Unlike typical minimum bills, most take-or-pay clauses allow pipelines to credit penalty payments to subsequent gas purchases that exceed the take-or-pay requirement. Because of this make-up period, take-or-pay clauses rarely, if ever, result in a pipeline paying for gas that it never receives.[22] Second, even if reductions in gas purchases increase pipelines' take-or-pay liabilities, this possibility does not undercut the Commission's rationale for Order No. 380; the elimination of minimum bills still encourages pipelines to institute market-responsive pricing of natural gas, and pipelines will not recover for variable costs they do not incur. Further, by lowering prices, which is a primary goal of the Commission's rule, pipelines can maintain sales to partial requirements customers and thus prevent take-or-pay exposure. Moreover, as the Commission found, this increased price competition may spur renegotiation of take-or-pay clauses with gas producers.

It is true that many of the policy considerations that support the elimination of variable cost recovery for the minimum bill

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[22] The Commission recognized, however, that pipelines incur carrying costs during this make-up period and that these costs may be recovered in the pipelines' rates. The Commission reasonably determined, however, that the concern that full requirements customers would bear a disproportionate share of these costs could best be addressed in individual rate cases. Given the deference appropriate to the Commission's choice of procedures, we cannot conclude that the deferral of "whether and under what circumstances take-or-pay carrying costs should be allocated separately from other costs," Order No. 380 at 44, J.A. at 835, was an abuse of discretion.

might support the elimination of take-or-pay clauses. As Commissioner Sousa expressed in his concurring opinion, take-or-pay provisions, like minimum bills, tend to discourage competition and keep natural gas prices artificially high. Order No. 380 (concurring opinion), J.A. at 862. Yet for the reviewing court to maintain its proper function, it cannot require agencies to solve all problems that may be related to a particular decision at the same time. That which we can require, the Commission has here provided: an explicit assessment of the relationship between the action taken and the issue deferred, and a reasonable conclusion that the public interest can best be advanced by the measured step taken.

(2) Impact Upon Full Requirements Customers

Perhaps the most serious consequence of Rule 380 is its impact upon the "captive" or full requirements customer. As explained above, full requirements customers purchase their entire natural gas supply from one pipeline and, because of their geographic location, are unable to swing off the system to obtain cheaper supplies of gas. Traditionally, minimum bills protected these captive customers from being forced to bear a disproportionate share of fixed costs. If partial requirements customers are permitted to swing off the system, remaining full requirements customers may be harmed in several ways. First, as the Commission explained, decreases in sales may increase a pipeline's take-or-pay payments, and these payments, if unrecovered, could then be passed on to full requirements customers in the form of increased fixed costs in their commodity charge. Second, pipelines might decrease purchased gas commitments (and thereby reduce take-or-pay exposure) and expose full requirements customers to curtailment of their contract entitlement.

The Commission found that the rule would benefit full requirements customers of *lower* priced pipelines because increased sales to new partial requirements customers would decrease each customers' share of fixed costs. "Thus, viewed

from a national perspective, the rule may create offsetting benefits and detriments to captive customers, depending on whether they are served by a high-cost or a low-cost pipeline." Order No. 380 at 33, J.A. at 824. "This national perspective," the Commission candidly recognized, "is small comfort to customers of a high-cost pipeline." *Id.*

The Commission concluded, however, that the harm to captive customers of higher priced pipelines would be isolated, of short duration, and outweighed by the overall long-term benefits to these customers that would result from increased competition. First, the Commission found that the pipelines themselves would initially absorb the costs associated with the loss of partial requirements customers because the pipeline must file a new rate case (a process that usually lasts six months) before passing such costs on to its remaining customers. Moreover, in its rate filing, the take-or-pay costs may be disallowed as imprudently incurred, or these costs may be allocated specially to the swinging partial requirements customers.[23] Second, "to the extent a pipeline loses sales as a result of its inability to meet competition," the Commission found, "its allowed return on equity may have to be adjusted," thereby reducing fixed costs to all customers. Order No. 380 at 35, J.A. at 826. Third, the Commission predicted that the increased incentive to compete vigorously in the market would eventually lead to lower prices for all customers. Finally, emergency procedures are available to assure that captive customers will not experience shortages in supply.

Petitioners advance no specific objection to the Commission's analysis but, rather, vaguely assert that the balance struck by the Commission is unwise. Had the Commission either failed to address the problems faced by captive customers or engaged in a less than candid balancing of the costs, its determinations

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[23] *See supra* note 22 (discussing Commission's intention to determine, on a case-by-case basis, the allocation of take-or-pay liabilities among partial and full requirements customers).

perhaps would be vulnerable on review. The Commission, however, exhaustively considered these problems, recognized that some harm would result from the elimination of minimum bills, indicated it would consider in individual cases whether particularly costs swings warrant special allotment of costs, and, finally, concluded that the benefit of increased competition would eventually inure to even the captive customer of a high-priced pipeline. These are the hard choices agencies are empowered — indeed required — to make. We therefore conclude that the Commission adequately addressed the concerns of captive customers.

d. Conclusion

In sum, we find that each of the order's essential elements is supported by substantial evidence. Since we have assured ourselves "that the Commission has given reasoned consideration to each of the pertinent factors," it is not our province "to supplant the Commission's balance of these interests with one more nearly to [our] liking." *Permian Basin,* 390 U.S. at 792.

2. Unique Claims

Most of the petitioners in this case assert that even if the rule generally is founded upon substantial evidence, unique circumstances render the rule inapplicable to them. Only two specific claims, however, warrant textual discussion.[24] First, several petitioners challenge as discriminatory the exemption granted to

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[24] We also conclude that the Commission properly denied waiver requests from petitioners Great Lakes and Transwestern Pipeline Co. in Order No. 380-A. The concerns raised by Great Lakes and Transwestern —exposure to take-or-pay liability, for example — were shared by most pipelines and adequately addressed in Order No. 380. *See* Order No. 380-A at 15-21, J.A. at 1470-76 (rejecting Great Lakes' request for a waiver); Order No. 380-A at 49-60, J.A. at 1504-1515 (rejecting Transwestern's request for a waiver).

We emphasize that we affirm only the waiver denials made in the Commission's Order No. 380 series. Other waiver applications made subsequent to the Order No. 380 series, despite protestations to the contrary, are not included in the present petitions for review

Northwest Alaskan Gas Company. Second, Midwestern Gas Transmission Company challenges the Commision's decision in Order No. 380-A that fixed costs charged by its pipeline supplier cannot be included in Midwestern's minimum bill.

a. Northwest Alaskan Pipeline Company's Exemption and the Alaskan Natural Gas Transportation System

In Order No. 3890-A, the Commission held that the rule eliminating minimum bills would not apply to Northwest Alaskan Pipeline Company's sales tariff. Northwest Alaskan's exemption from the rule is based upon its participation in the Alaskan Natural Gas Transportation System (ANGTS). Petitioners Transwestern, Algonquin, and Great Lakes contend in variously articulated arguments that because they purchase gas from Canadian suppliers, there is no rational basis for the Commission's decision to apply the rule to their respective tariffs, while exempting Northwest Alaskan's tariff.[25]

Pursuant to the Alaska Natural Gas Transportation Act (ANGTA), 15 U.S.C. § 719 (1982), and an agreement between

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and therefore are not properly before this court. *See, e.g.*, Great Lakes Transmission Co., 29 FERC ¶61,135 (1984), *reh'g denied*, 30 FERC ¶61,263 (1985) (denying waiver requests filed by Great Lakes, MIGC, and Midwestern).

Similarly, petitioner Pacific Interstate Offshore Co. (PIOC) currently has a waiver application pending before the Commission. Should PIOC be dissatisfied with the Commission's resolution of the issue, it can appeal the denial of the exemption. We find it inappropriate to determine the issue raised by PIOC until the Commission in the first instance has had an opportunity to rule on whether PIOC's unique circumstances warrant exemption.

[25] Algonquin claims that the orders under review are unlawfully discriminatory under sections 4 and 5 of the Act, Brief for Algonquin at 52, while Transwestern and Great Lakes contend that the exemption is arbitrary and capricious. Brief for Transwestern at 47-49; Brief for Great Lakes at 49-52.

Canada and the United States,[26] President Carter in 1977 issued a decision approving the construction of a 5,000-mile pipeline, which will eventually connect Alaskan gas reserves, through Canada, with markets in the contiguous United States.[27] In 1980, prior to the commencement of Alaskan gas deliveries, the Commission in a series of orders authorized the "prebuilding" of the Southern Canadian and United States segments of the system. To secure Canadian participation in the project and to assure Canadian investors that the construction of this segment could be properly financed, the Commission authorized the importation by Northwest Alaskan of approximately 1.04 Bcf per day of Canadian natural gas from Pan-Alberta Gas Ltd. After extensive negotiations, the Commission in its decision approving Northwest Alaskan's contract with its Canadian supplier, also crafted a contract formula that guaranteed the Canadian suppliers an adequate revenue stream generated from United States sales. In this regard, the Commission specifically recognized the importance of assuring a minimum stream of revenue to support the financing of the ANGTS and promised that it "would not change the principles upon which the revenue stream is calculated during the authorization of the imports."[28] After receiving requested assurances from the President and Congress of the United States' commitment to the project, the Canadian government in 1980 permitted the project to go forward.

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[26] Agreement Between the United States of America and Canada on Principles Applicable to the Northern Natural Gas Pipeline, 29 U.S.T. 3581, T.I.A.S. No. 9030.

[27] Decision and Report by Congress on the Alaska Natural Gas Transportation System (Sept. 22, 1977), ratified H.J. Res. 621, Publ. L. No. 92-158, 91 Stat. 1268, 95th Cong., 1st Sess. (Nov. 8, 1977).

[28] Northwest Alaskan Pipeline Co., 11 FERC ¶ 61,302 at 61,605 (June 20, 1980).

Due to ambiguities in the Commission's May 1984 Order No. 380, it was not possible to determine whether the ban on variable cost recovery through minimum bills extended to Northwest's minimum take provisions. The uncertainty generated comments from the Canadian government, the Economic Regulatory Administration, and the Undersecretary of State, urging the Commission to reconsider the impact of Order No. 380 upon the prebuilt segments of the ANGTS. On July 30, 1984, the Commission issued Order No. 380-A, stating explicitly that the Rule did not apply to Northwest's sales tariff. The Commission exempted Northwest because "ANGTS is a unique international project whose ultimate success has always rested on a framework of mutual trust and cooperation between the governments of the U.S. and Canada." Order No. 380-A at 95, J.A. at 1550. Furthermore, "any subsequent action that could adversely affect [the] stream of revenue [underpinning the financing of the Canadian segment of the ANGTS] would constitute a breach of our nation's relationship with Canada." *Id.*, at 96. J.A. at 1551. In order No. 380-B, the Commission denied Transwestern's application for rehearing on the Northwest exemption and reaffirmed the uniqueness of the ANGTS project.

Petitioners Great Lakes, Algonquin, and Transwestern argue that by exempting Northwest the Commission has unlawfully discriminated against them and other similarly situated pipelines because, they contend, there is no substantial difference between their positions with respect to their Canadian suppliers and Northwest's position with respect to its Canadian supplier.[29] This contention is wholly without merit. The only similarity between petitioners and Northwest is that they all import Canadian gas. None of the petitioners participate in the ANGTS but instead merely purchase gas supplies from Canadian producers. Thus, although their Canadian producers rely on the revenue stream

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[29] Brief for Algonquin at 50-52; Brief for Great Lakes at 49-52; Brief for Transwestern at 47-49.

generated by petitioners' domestic operations, such reliance is not based upon explicit assurance from the Commission that it would not change the principles upon which the revenue stream is calculated during the authorization of the imports[30] Northwest's operations, unlike petitioners', involve a matrix of agreements entered into by the regulatory bodies of the United States and Canada necessary to endure the successful completion of the massive trans-Canada pipeline. Application of the rule to Northwest's tariff would have placed the United States in breach of its explicit commitments to Canada. Moreover, ANGTS has received on more than one occasion the special attention of the President and Congress. Thus, the diplomatic considerations cited by the Commission apply only to Northwest and are not relevant to petitioners' contracts. Therefore, the Commission has provided sufficient evidence of the differences between these tariffs, *see St. Michaels Utilities Commission* v. *FPC*, 377 F.2d 912, 915 (4th Cir. 1967) ("where there exists a difference in rates which is attacked as illegally discriminatory, judicial inquiry devolves on the question of whether the record exhibits factual differences to justify classifications among customers and differences among the rates charged them"), and we cannot conclude that the distinction drawn by the Commission on the basis of this unique situation is an unreasonable one. *See Metropolitan Edison Co.* v. *FERC*, 595 F.2d 851, 857 (D.C. Cir. 1979) ("A difference in rate treatment is not unduly discriminatory when the difference is amply justified . . . ."). We therefore conclude that the Commission has not unreasonably discriminated against petitioners by exempting Northwest from the rule.

B. Downstream Pipeline Issue

Most pipelines subject to the Commission's jurisdiction purchase their gas supplies directly from producers in gas

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[30] See *supra* note 28.

producing areas. The pipeline then transports the gas to market areas and sells the gas to its customers in those areas. Some pipelines, however, do not purchase gas directly from a producer, but instead purchase gas "downstream" from another pipeline. Under this system of transmission, the upstream pipeline purchases the gas from the producer and then transports the gas from the gas producing area to the location of its facilities. The downstream pipeline then purchases the gas from the upstream pipeline and transports the gas to the market areas.

Petitioner Midwestern is a downstream pipeline that purchases most of its gas supply from an affiliate pipeline, Tennessee Gas Pipeline, Inc. Tennessee sells gas to Midwestern pursuant to a minimum bill. The commodity charge in Tennessee's minimum bill includes charges for both fixed and variable costs incurred by Tennessee. Midwestern then transports the gas from Tennessee's facilities to its market area and sells the gas pursuant to a minimum bill which contains a commodity charge reflecting Midwestern's fixed and variable costs.

In response to the Commission's statement that the objective of Order No. 380 is "the elimination from natural gas pipeline sales tariffs of any minimum commodity bill provisions that operate to recover variable costs," Order No. 380 at 1, J.A. at 792, Midwestern requested that the Commission clarify its decision by stating that "only the variable cost portion of the upstream pipeline's commodity charge be considered variable for purposes of the downstream pipeline's commodity charge." Order No 380-A at 33, J.A. at 1488. The requested clarification would have permitted Midwestern to include both the fixed-cost component of Tennessee's commodity rates and the fixed-cost component of Midwestern's commodity rates in Midwestern's minimum bill.

In Order No. 380-A, the Commission denied Midwestern's request and held instead that Midwestern could recover any minimum bill charges for fixed costs by debiting these charges to

its unrecovered purchased gas cost account. Midwestern could then recover the charges in its semi-annual purchased gas cost adjustment filing through higher commodity rates for all of its customers. Thus, under the Commission's decision, Tennessee's fixed costs cannot be included in Midwestern's minimum bill but instead will be charged to each of Midwestern's customers in proprortion to the amount of gas taken by that customer.

In its decision, the Commission agreed that the "desire to collect for these costs is entirely reasonable, since the downstream pipelines do actually incur the upstream pipeline's fixed costs," Order No. 380-A at 33-34, J.A. at 1488-89, but concluded:

> The Commission considers the cost a downstream pipeline pays an upstream pipeline for gas to be a "purchased gas cost," regardless of what types of costs make up the total charge for the gas. As a "purchased gas cost," the entire amount paid for the gas is considered variable and is recovered through the purchasing pipeline's commodity charge. To treat purchased gas costs in any other manner would constitute a departure from consistent Commission rate design practice.

Id. at 33, J.A. at 1488. This statement, quoted in its entirety, is the Commission's sole justification for its decision.

In its petition to this court, Midwestern argues that the Commission's decision is discriminatory because its effect will misallocate costs among Midwestern's customers by forcing other customers to bear those fixed costs of the system that cannot be charged to minimum bill customers. Midwestern also argues that those increased commodity rates that will result from the Commission's decision will impair its ability to compete with pipelines who purchase gas directly from producers, and is thus discriminatory and contrary to the asserted pro-competitive rationale of the rule. Finally, Midwestern argues that the decision is directly contrary to the Commission's "as-billed" principle, which governs the allocation of upstream pipeline

charges in downstream pipeline rates. This principle provides that "the cost classification, allocation, and rate design methodology specified by the Commission for that pipeline supplier governs the classification of these costs by the recipient interstate pipeline." *Northwest Alaskan Pipeline Co.*, 11 FERC ¶ 61,088 at 61,182, *reh'g denied*, 11 FERC ¶ 61,302 (1980).

The Commission's sole response to these arguments is that it considers all of the upstream pipeline's charges to be purchased gas costs and "[t]o treat purchased gas costs in any other manner would constitute a departure from consistent rate design practice."[31] Order No. 380-A at 33, J.A. at 1488. The Commission has provided no explanation regarding the apparent inconsistency between the "as-billed" principle and this undefined "consistent rate design practice." The Commission has given no rational explanation for its departure from the clear objective stated in Order No. 380 to exempt fixed cost recovery through minimum bills from that decision. The Commission does not discuss Midwestern's facially valid argument that it will be placed at a competitive disadvantage if the upstream fixed costs are recovered from all of its customers through increased commodity rates. The Commission has not explained its apparent conclusion that Midwestern's minimum bill customers should be relieved of their obligation to pay their share of the fixed costs of the upstream segment of the system while other pipelines' minimum bill customers must pay their share of the fixed costs of the entire system. In short, the Commission has not given a reasoned explanation for its decision but has merely stated its conclusion. Under these circumstances, we are unable to reach a decision as to the validity of the Commission's decision, and we certainly cannot conclude from the record that the Commission has "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action, including a 'rational connection

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[31] The Commission did not address the downstream pipeline issue in its brief to this court.

between the facts found and the choice made.' " *Motor Vehicle Manufacturer's Association* v. *State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168, (1962)). Therefore, we remand this issue to the Commission for reconsideration.[32] On remand, the Commission is directed to address any issues raised here, and any other arguments that may be advanced, and to provide a rational and reasoned explanation for the ultimate disposition of this issue.

IV. Procedural Objections

Petitioners content the Commission abused its discretion by engaging in informal notice and comment rulemaking because (1) the unique factual circumstances advanced by each pipeline merited individualized case-by-case adjudication; and (2) notice and comment rulemaking cannot produce the "substantial evidence" required by section 19 of the NGA.[33]

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[32] On August 14, 1984, Midwestern filed with the Commission a petition for a limited waiver of Order No. 380. In this petition, Midwestern sought permission to include a provision in its tariff directly assigning the fixed costs in Tennessee's commodity rates to the appropriate customers. The Commission denied the petition as prematurely raised and concluded that if a misallocation of costs does actually occur, the affected customers could file a complaint under section 5 alleging undue preference or discrimination, or alternatively, Midwestern could submit a proposed allocation of costs in its next rate filing. Order on Petitions to Permit Waiver of Commission Rule, 29 FERC ¶ 61,135 at 61,277 (1984). Again, we wish to emphasize that this petition is not properly before this court, *see supra* note 24, and is in no way affected by our decision here. We address only Midwestern's challenge to the Commission's decision in Order No. 380-A that upstream fixed costs cannot be included in Midwestern's minimum bill. This argument is not premature because the Commission's decision presently precludes any upstream fixed-cost component in Midwestern's minimum bill. *See* 15 U.S.C. § 717r (1982).

[33] Petitioner Great Lakes also contends the Notice of Proposed Rulemaking did not give "a description of the subjects or issues involved," 5 U.S.C. § 553(b)(3), sufficient to afford "interested parties a reasonable opportunity to participate in the rulemaking."

A. *Choice Between Rulemaking and Adjudication.*

It is a well-settled principle of administrative law that the decision whether to proceed by rulemaking or adjudication lies within the broad discretion of the agency. *See SEC* v. *Chenery Corp.*, 332 U.S. 194, 202-203 (1947) ("[A]n administration agency must be equipped to act either by general rule or individual order. To insist upon one form of action to the exclusion of the other is to exalt form over necessity. . . .[T]he choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency.") This deference is particularly appropriate in this case, where "the breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968).

The decision by the Commission to proceed by rulemaking rather than through case-by-case adjudication clearly passes muster under our deferential standard of review. The petitioner's vague and conclusory assertions that each of their peculiar circumstances render a generic rulemaking inappropriate merely echo their substantive quarrel with the reasonability of the Commission's decision.[34] As we have established, substantial evidence

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Trans-Pacific Freight Conference of Japan/Korea v. Federal Maritime Comm'n, 650 F.2d 1235, 1248 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 984 (1981). Brief for Great Lakes at 35-36. This claim is frivolous. Although Great Lakes initially seemed to be under the impression that the proposed rule covered only situations in which pipelines incurred take-or-pay liability, *see* J.A. at 116, an impression not shared by the other 94 interested parties, it exercised its opportunity to participate in the rulemaking by submitting extensive initial and reply comments. *See* J.A. at 112-35, 722-30, 998-1027, 1648-69.

[34] MIGC, for example, states that the overrecovery rationale does not apply to it because any payments under its minimum bill "would reflect, at least in part, costs that are incurred under the take-or-

supports the Commission's conclusion that minimum bills and minimum take provisions have two industry-wide effects: minimum bills can result in the recovery of unincurred costs and are anticompetitive. The generalized nature of the problems addressed, therefore, did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties.[35] Rather, notice and comment rulemaking, particularly appropriate for determination of legislative facts and policy of general, prospective applicability, was a manifestly reasonable method of addressing the systemic problems of the natural gas market. *See National Small Shipments Traffic Conference, Inc.* v. *ICC*, 725 F.2d 1442, 1447-48 (D.C. Cir. 1984). *See also Trans-Pacific Freight Conference of Japan/Korea* v. *Federal Maritime Commission*, 650 F.2d 1235, 1245 (D.C. Cir. 1980) ("Rulemaking permits more precise definition of statutory standards than would otherwise arise through protracted piecemeal litigation of particular issues."), *cert denied*, 451 U.S. 984 (1981).[36]

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pay or take-and-pay clauses in MIGC's contracts with its suppliers." Brief for MIGC, Inc. at 31. Take-or-pay clauses, however, are hardly unique; the Commission received substantial comments on and devoted a considerable amount of attention to the take-or-pay issue. *See* discussion *supra* p. 40 ("Harm to Pipelines—The Take-or-Pay Issue").

[35] Great Lakes' contention that the Commission has violated its due process rights, Brief for Great Lakes at 45-46, therefore, are completely without merit. *Compare* Londoner v. Denver, 210 U.S. 373 (1908) (individualized public works assessments require individual hearings), *with* Bi-Metallic Investment Co. v. State Board of Equalization, 239 U.S. 441 (1915) (general community-wide tax increases do not).

[36] Indeed, case-by-case adjudication of the miniumum bill issue may have been entirely inappropriate. First, if the Commission determined in a particular case that a pipeline's minimum bill was "unjust" and "unreasonable," that pipeline would be subjected to competition from other pipelines whose mimimum bills had not yet been prohibited by the Commission. Second, the Commission would be open to the objection that it was unfairly effectuating a general policy change without the necessary, industry-wide data

B. *Informal Rulemaking and the Substantial Evidence Requirement of Section 5 of the Natural Gas Act*

Relying on *Mobil Oil Corp.* v. *FPC*, 483 F.2d 1238 (D.C. Cir. 1973), several petitioners contend that the "substantial evidence" standard of review mandated by section 19 of the NGA[37] cannot be satisfied through informal notice and comment rulemaking. In *Mobil Oil*, this court stated that informal notice and comment rulemaking "cannot create a record that satisfies the substantial evidence test." *Id.* at 1260. The Court held:

> In the type of proceeding on which the Commission eventually embarked, the standard of evidence which a reviewing court must have before it to sustain the agency's action is "substantial evidence" as called for by the basic statute here involved, the Natural Gas Act. The procedures required to develop this "substantial evidence" are not necessarily the strict adversary procedures of sections 556 and 557 of the Administrative Procedure Act, but, considering the ultimate decision which the Commission issued, should have embraced considerably more in the way of adversary procedures than those simple requisites of section 553 which were assumed sufficient here.

Id. at 1264.

There are two possible reading sof the *Mobil Oil* case. First, the holding of the case could be limited to the facts presented: because interested parties were not provided with adequate notice, the written submissions did not provide substantial evidence in the record for the ultimate decision which the Commission issued.[38] Second, the case could be read to mandate, in

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and commentary. *See* United States v. Florida East Coast Ry. Co. 410 U.S. 224, 245, (1973) (rulemaking is generally the appropriate method for promulgating policy-type rules and standards).

[37] 15 U.S.C. § 717r (1982) ("The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive.")

[38] In American Public Gas Ass'n v. FPC, 498 F.2d 718, 723 (D.C. Cir. 1974), for example, we distinguished *Mobil Oil* on these grounds: "In the *Mobil Oil* case there was no adequate notice, and

all rulemakings in which "substantial evidence" is required, something more than section 553 informal proceedings. It is for this latter proposition that the petitioners here cite the case.

The petitioners' reading of *Mobil Oil* is a fair one. The case, however, is no longer good law. *Mobil Oil* proceeds from an assumption, long held by this court, that " 'procedural requirements deemed inherent in the very concept of fair hearing' " could be fashioned by the court " 'even though no such requirements had been specified by Congress.' " *Id.* at 1252 (quoting *American Airlines Inc.* v. *CAB*, 359 F.2d 624, 632 (D.C. Cir.), *cert. denied*, 385 U.S. 843 (1966). A unanimous Supreme Court, however, rejected this principle with great force and clarity in *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519 (1978). In *Vermont Yankee*, the Court found that nothing "permitted the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory *minima.*" *Id.* at 548.

Although the *Mobil Oil* case has been cited without disapproval by this court in recent cases,[39] to the extent that it imposes procedural requirements not required by the Natural Gas Act or the Administrative Procedure Act it cannot survive *Vermont Yankee*. Furthermore, as we specifically held in *American Public Gas Association* v. *FPC*, 567 F.2d 1016 (D.C. Cir. 1977), the "substantial evidence" provision in the Natural Gas Act does not affect the *procedure* the Commission is required to follow:

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much of the data relied upon by the Commission was provided in an informal and to some extent *ex parte* conference, as distinguished from an adversary setting." As we later recognized, the *American Public Gas* case is "otherwise in conflict with the hearing discussion in *Mobil*." American Public Gas Ass'n v. FPC, 567 F.2d 1016, 1066 (D.C. Cir. 1977).

[39] *See* City of Ukiah v. FERC, 729 F.2d 793, 799 (D.C. Cir. 1984); Iowa State Commerce Comm'n v. Office of Federal Inspector, 730 F.2d 1566, 1574 (D.C. Cir. 1984).

> We have not overlooked the contention that the provision of the Natural Gas Act requiring substantial evidence to support an essential element of the Commission's order, *Permian,* 390 U.S. at 792, 88 S.Ct. 1344, calls for a trial-type hearing. Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b). In our view, however, this requirement, found in the judicial review provision of the Act, does not dictate the procedure to be followed, or the nature of the hearing to be held. It has to do with a court's review of the adequacy *vel non* of the evidence relied upon to support a finding, whatever the kind of hearing. True it may be that when rulemaking is based on written submissions the weight to be accorded the evidence may be affected by that method of presentation, but the standard of substantial evidence may be satisfied by written submissions.[40]

Id. at 1067. The notice and comment rulemaking employed by the Commission, therefore, satisfies the procedural requirements of both the Natural Gas Act and the Administrative Procedure Act.[41]

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[40] *See also* Public Systems v. FERC, 606 F.2d 973, 979 n.32 (D.C. Cir. 1979) (substantial evidence requirement in the Natural Gas Act "carries no implications for procedures to be followed by the Commission in compiling the record"). The Supreme Court in United States v. Florida East Coast Ry. Co., 410 U.S. 224 (1973), made a similar observation concerning an amendment to the Interstate Commerce Act: "Congress . . . specified necessary components of the ultimate decision, but it did not specify the method by which the Commission should acquire information about these components." *Id.* at 235.

[41] The *American Public Gas* case also disposes of petitioners' related contention that the "after a hearing" requirement found in § 5 of the NGA, 15 U.S.C. § 717d (1982), cannot be satisfied through less than formal, trial-type hearings. In *American Public Gas,* the Commission gave interested parties an opportunity to participate through appropriate submissions but did not provide an opportunity to cross-examine or examine under oath other parties who had made submissions. 567 F.2d at 1064. This procedure, the court held, satisfied the hearing requirement of the Natural Gas Act. *Id.* at 1067.

V. Conclusion

For the foregoing reasons, Orders No. 380, 380-A -D, are affirmed. The "Downstream Pipeline Issue" is remanded to the Commission for proceedings consistent with this opinion.

So ordered.

APPENDIX B

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 84-1358

September Term, 1984

WISCONSIN GAS COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PEOPLES GAS LIGHT AND COKE COMPANY,
PUBLIC SERVICE COMMISSION OF WISCONSIN,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
COLUMBIA GAS TRANSMISSION CORPORATION,
STATE OF MICHIGAN, et al.,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
CHATTANOOGA GAS COMPANY,
PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
NORTHWEST ENERGY COMPANY, INTERVENORS

No. 84-1359

ANR PIPELINE COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
COLORADO INTERSTATE GAS COMPANY,
PEOPLES GAS LIGHT AND COKE COMPANY,
PUBLIC SERVICE COMMISSION OF WISCONSIN,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
COLUMBIA GAS TRANSMISSION CORPORATION,
STATE OF MICHIGAN, et al.,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
CHATTANOOGA GAS COMPANY,
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK, INTERVENORS

No. 84-1360

GREAT LAKES GAS TRANSMISSION COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,

EL PASO NATURAL GAS COMPANY,
TRANSCANADA PIPELINES LIMITED,
PUBLIC SERVICE COMMISSION OF WISCONSIN,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
COLUMBIA GAS TRANSMISSION CORPORATION,
STATE OF MICHIGAN, et al.,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1364

TRANSWESTERN PIPELINE COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PUBLIC SERVICE COMMISSION OF WISCONSIN,
NATURAL GAS PIPELINE COMPANY OF AMERICA,
COLUMBIA GAS TRANSMISSION CORPORATION,
STATE OF MICHIGAN, et al.,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1407

MIDWESTERN GAS TRANSMISSION COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
PEOPLES GAS LIGHT AND COKE COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1408

TENNESSEE GAS PIPELINE COMPANY,
A DIVISION OF TENNECO INC., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,

SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
PEOPLES GAS LIGHT AND COKE COMPANY,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1413

CITY GAS COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1414

MADISON GAS & ELECTRIC COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1415

WISCONSIN POWER & LIGHT COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,

BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1416

WISCONSIN NATURAL GAS COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1417

WISCONSIN POWER & LIGHT COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPELINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1418

WISCONSIN PUBLIC SERVICE CORPORATION, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
PROCESS GAS CONSUMERS GROUP, et al.,
PACIFIC INTERSTATE OFFSHORE COMPANY, et al.,
SOUTHERN CALIFORNIA GAS COMPANY, et al.,
MICHIGAN GAS UTILITIES COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
EL PASO NATURAL GAS COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY, et al.,
INTER-CITY GAS CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY, et al.,
BROOKLYN UNION GAS COMPANY,
COLUMBIA GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
INTERVENORS

No. 84-1433

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN GAS UTILITIES COMPANY,
STATE OF MICHIGAN, et al.,
MICHIGAN CONSOLIDATED GAS COMPANY,

CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1434

TRUNKLINE GAS COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN GAS UTILITIES COMPANY,
STATE OF MICHIGAN, et al.,
MICHIGAN CONSOLIDATED GAS COMPANY,
CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1441

MIGC, INC., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1446

TEXAS EASTERN TRANSMISSION CORPORATION, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

MICHIGAN CONSOLIDATED GAS COMPANY,
CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1463

ARKANSAS LOUISIANA GAS COMPANY,
a Division of Arkla, Inc., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY, INTERVENORS

No. 84-1470

TRANSCONTINENTAL GAS PIPE LINE CORPORATION, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PAN-ALBERTA GAS LTD., et al.,
PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
PUBLIC SERVICE ELECTRIC AND GAS COMPANY,
KANSAS STATE CORPORATION COMMISSION,
CONSOLIDATED GAS TRANSMISSION CORPORATION,
WASHINGTON GAS LIGHT COMPANY, INTERVENORS

No. 84-1474

ALGONQUIN GAS TRANSMISSION COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PAN-ALBERTA GAS LTD., et al.,
CONSUMERS POWER COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY,
NORTHERN ILLINOIS GAS COMPANY, INTERVENORS

No. 84-1487

TEXAS GAS TRANSMISSION CORPORATION, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al.,
NORTHERN ILLINOIS GAS COMPANY,
NATURAL GAS PIPELINE COMPANY OF AMERICA, INTERVENORS

No. 84-1489

PACIFIC INTERSTATE OFFSHORE COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

CONSUMERS POWER COMPANY,
NORTHERN ILLINOIS GAS COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY,
PACIFIC LIGHTING SUPPLY COMPANY, et al.,
PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1490

CASCADE NATURAL GAS CORPORATION,
NORTHWEST NATURAL GAS COMPANY,
WASHINGTON NATURAL GAS COMPANY, PETITIONERS
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

CONSUMERS POWER COMPANY,
PAN-ALBERTA GAS LTD., et al.,
NORTHERN ILLINOIS GAS COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY, INTERVENORS

No. 84-1556

ARKANSAS LOUISIANA GAS COMPANY,
a division of Arkla, Inc., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PACIFIC GAS AND ELECTRIC COMPANY, et al., INTERVENORS

No. 84-1580

TRANSWESTERN PIPELINE COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PAN-ALBERTA GAS LTD., et al., INTERVENORS

No. 84-1623

MIGC, INC., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

No. 85-1015

ARKANSAS LOUISIANA GAS COMPANY,
a Division of Arkla, Inc., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

Before: TAMM, MIKVA, and STARR, Circuit Judges.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 83-1358 et al.
September Term, 1984

JUDGMENT

These causes came on to be heard on the petitions for review of orders of the Federal Energy Regulatory Commission, and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by this Court, that the orders No. 380, 380-A-D, are affirmed. The "Downstream Pipeline Issue" is remanded to the Commission for proceedings consistent with the Opinion for the Court filed herein this date.

Per Curiam
For The Court

George A. Fisher
Clerk

Date: August 20, 1985
Opinion for the Court filed by Circuit Judge Tamm.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM 1985

WISCONSIN GAS COMPANY, et al.

v.

FEDERAL ENERGY REGULATORY COMMISSION AND CONSOLIDATED CASES

No. 84-1358

BEFORE: Mikva and Starr, Circuit Judges

ORDER

Upon consideration of petitions for rehearing of ANR Pipeline Company, Texas Gas Transmission Corporation, and Arkla Energy Resources, it is

ORDERED, by the Court, that the petitions are denied.

Per Curiam

FOR THE COURT

GEORGE A. FISHER, *Clerk*

BY: ROBERT A. BONNER
Robert A. Bonner
Chief Deputy Clerk

October 25, 1985

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM 1985

WISCONSIN GAS COMPANY, et al.

v.

FEDERAL ENERGY REGULATORY COMMISSION AND CONSOLIDATED CASES

No. 84-1358

BEFORE: Robinson, Chief Judge; Wright, Wald, Mikva, Edwards, Ginsburg, Bork, Scalia and Starr, Circuit Judges

ORDER

The suggestions for rehearing *en banc* of ANR Pipeline Company, Texas Gas Transmission Corporation and Arkla Energy Resources have been circulated to the full Court and no member has requested the taking of a vote thereon. Upon consideration of the foregoing, it is

ORDERED, by the Court *en banc*, that the suggestions for rehearing *en banc* are denied.

Per Curiam

FOR THE COURT

GEORGE A. FISHER, *Clerk*

BY: ROBERT A. BONNER
Robert A. Bonner
Chief Deputy Clerk

October 25, 1985

Circuit Judge Wald did not participate in this order.

APPENDIX D

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, J. David Hughes, A. G. Sousa and Oliver G. Richard III.

Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions } Docket No. RM83-71-000

ORDER NO. 380
FINAL RULE
(Issued May 25, 1984)

I. *Introduction*

The Federal Energy Regulatory Commission (Commission) is amending Part 154 of its regulations[1] by the addition of a new § 154.111 that requires elimination from natural gas pipeline sales tariffs of any minimum commodity bill provisions that operate to recover variable costs.

II. *Explanatory Background*

The sales rates of most natural gas pipelines regulated by this Commission consist of two parts. The first part is a demand charge, which recovers a certain portion of a pipeline's fixed costs.[2] The demand charge is a reflection of the contractual obligations between the pipeline and the customer, respectively, to

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[1] 18 C.F.R. Part 154 (Natural Gas, reporting and recordkeeping requirements).

[2] Fixed costs are those that do not vary, regardless of the level of usage of the pipeline. Examples of fixed costs are principal/interest on debt, return of and on equity, and income taxes. The portion of fixed costs that is collected via the demand charge depends on the way a particular pipeline's costs are classified. The apportionment of fixed costs among various jurisdictional customers also depends on both cost allocation and rate design.

provide and pay for a particular service. As such, the demand charge is paid each billing period (month) regardless of the level at which a customer purchases natural gas during that period.

The second part of the sales rate is a commodity charge. The commodity charge includes whatever fixed costs are not included in the demand charge. It also includes the pipeline's variable costs.[3] The commodity charge is levied on each unit of gas sold; consequently the amount paid by a customer each billing period varies according to the amount of gas purchased. It is the commodity portion of pipeline rates with which the Commission is concerned in this rule.[4]

A number of pipelines include in certain of their sales rate schedules a provision known as a "minimum commodity bill." The minimum commodity bill generally requires the customer to pay the full commodity charge for a specified percentage of its contract entitlement[5], whether or not the customer actually takes gas at that percentage level. For example, if a minimum commodity bill is set at 75 percent per month, the customer must

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[3] Variable costs are those that vary depending on the volume level of deliveries through the pipeline. By far the largest variable cost in a pipeline's rates is the cost of purchased gas.

[4] Commodity charges may take different forms from tariff to tariff. For example, some pipelines have two separate commodity charges. One is intended to recover all "gas costs" (i.e., purchased gas costs and expenses related to the cost of gas, such as compressor fuel and line losses). The other is intended to recover "non-gas costs." For purposes of this rule, the Commission makes no distinction among single or dual commodity rate charges, straight-line rate charges, cost-of-service rate charges, or any other label that may be placed upon the form within which variable costs are collected.

[5] A customer's contract entitlement (this term may vary from pipeline to pipeline) can be generally described as the maximum amount of natural gas a customer is entitled to demand from a pipeline during a given period. During a peak demand period, a customer may need to purchase at its full entitlement level. During an off-peak period, it may buy at far below its entitlement level.

pay the commodity charge for 75 percent of its entitlement during the billing period, even if it is only taking at 50 percent of that level.[6]

Thus, a minimum commodity bill ensures a pipeline recovery of a certain percentage of the fixed costs that are in the commodity component of its rates. But at the same time, it also ensures a pipeline recovery of a certain percentage of the variable costs as well. The presence of variable costs in a minimum commodity bill does two things about which the Commission is concerned. First, in cases where a customer is taking gas below its minimum commodity bill level, the minimum commodity bill operates to recover variable costs that are not actually incurred by the pipeline. Second, a minimum commodity bill can serve as a barrier to competition. A customer is not likely to purchase gas from an alternate supplier if it is required to pay for gas it does not take from the original supplier.[7] As such, a minimum commodity bill may inhibit natural gas price decreases that could otherwise result from competitive forces.

Concern about two factors led the Commission to issue on August 15, 1983, a Notice of Proposed Rulemaking[8] pursuant to

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[6] Minimum commodity bills are generally figured by multiplying the set percentage level of the customer's maximum daily quantity under its contract by the commodity charge times the number of days in the month. Some minimum bills are calculated and billed annually. The Notice of Proposed Rulemaking in this docket noted that set percentages may range from 66 percent to above 90 percent. 48 Fed. Reg. 39238.

[7] By contrast, if the minimum commodity charge a customer must pay each month is limited to the fixed cost component of the minimum bill, some customers may find it economically advantageous to incur the minimum bill yet purchase gas from another supplier. This would occur if the differential between the two suppliers' commodity prices is larger than the fixed cost component of the original supplier's minimum bill. *See, e.g.*, comments of Consolidated Edison Company of New York, Inc.

[8] 48 Fed. Reg. 39238, August 30, 1983; FERC Stats. and Regs., Proposed Regulations ¶ 32,334 (1983) (cited hereinafter as "Notice").

sections 4, 5 and 6 of the Natural Gas Act.[9] In that Notice, the Commission announced its intent to eliminate variable costs from minimum commodity bills to the extent such tariff provisions permit recovery of costs not actually incurred. The Commission sought public comment on this proposal.

Ninety-five comments reflecting the views of pipelines, distributors, end-users, and public bodies were initially filed in this docket.[10] Further, in response to the suggestions of a number of commenters, the Commission provided for a round of reply comments[11] in order to join the various issues raised. Thirty reply comments were filed.

Many of the comments in the record before us provide detailed charts and other factual information setting forth historical developments in the industry as well as the specific situations faced by pipelines or customers. Some provide hypothetical examples of situations that could arise. These figures and examples have been very helpful to the Commission in its study of the minimum commodity bill question.

On the basis of the record thus established, the Commission has determined that collection of variable costs via a pipeline's minimum bill tariff provision is unjust and unreasonable under the Natural Gas Act, and that a final rule should be issued to implement this finding. The Commission's reasons for doing so and its findings on issues raised by the commenters are set forth *infra*.

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[9] 15 U.S.C. § 717-717w (1976).

[10] *See* Appendix for list of commenters. Comments filed out of time are hereby accepted in view of the fact that no party has suffered a detriment as a result of Commission consideration of late-filed comments.

[11] Notice of Opportunity to File Reply Comments, 49 Fed. Reg. 3093 (January 25, 1984).

III. *Historical Background*

Minimum commodity bills are not a new phenomenon. The Notice in this docket cited a landmark 1967 case in which the Commission considered what the functions of a minimum commodity bill might be.[12] In that case it identified three ratemaking functions that could possibly justify pipeline minimum bills: fixed cost recovery; equitable recovery of both fixed and variable costs; and take-or-pay recovery. These functions, which are interrelated, will be briefly reviewed in the context of the following background information.

A. *Two Types of Pipeline Customers*

Jurisdictional pipeline sales customers can generally be divided into two types. The first is the "full requirements" customers, so called because they purchase their entire natural gas supply from one pipeline. Full requirements customers are sometimes referred to as "captive" customers since, in most cases, they are geographically located in areas where there is only one pipeline supplier. Local distribution companies, both privately and publicly owned, generally make up this group.[13]

The other general type is the "partial requirements" customers, so called because they do not rely solely on one pipeline for their gas supply. Partial requirements customers are sometimes referred to as "swing" customers, since they are geographically located in areas where they can swing from one source of supply to another (assuming that physical connections have been installed). Local distributors and other pipelines make up this group.

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[12] Notice at p. 32,669, citing Atlantic Seaboard Corp., 38 F.P.C. 91, 95 (1967).

[13] Some industrial customers served directly by the pipeline, rather than through an intermediary distributor, may be similarly "captive." The Commission's jurisdiction does not extend, however, to the rates charged by pipelines to these types of customers.

There is some tension inherent in the relationship between full and partial requirements customers. This tension is due to the nature of the gas industry itself. Interstate pipeline systems were designed based on the estimated markets of both full and partial requirements customers. Large scale investments were made to provide physical facilities and long-term supplies of gas to serve both groups. Costs reflecting these commitments have therefore traditionally been considered the responsibility of both groups. For this reason, the Commission designs a pipeline's rates so as to allocate fixed costs among both types of customers, based on their annual and peak period usage of the system. In this manner an equitable allocation of fixed costs is achieved.

To the extent that fixed costs are included in the demand portion of the rate, the pipeline is assured of their recovery. But to the extent they are included in the commodity portion, they are at risk to the pipeline.[14] To the extent that a customer takes less gas than expected, the pipeline does not collect the commodity charge for as much gas as it had planned to sell. If it cannot sell that gas elsewhere, the pipeline may underrecover some of its fixed costs. It is at this point that the tension can arise between full and partial requirements customers.

Partial requirements customers have the ability to swing off the system, causing a reduction in expected sales volumes which, in turn, creates an underrecovery of costs. If the pipeline is

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[14] While all production-related fixed costs are in the commodity charge, the portion of storage- and transmission-related fixed costs in the commodity charge varies. For pipelines that are on the *"United"* methodology, 75 percent of these fixed costs are in the commodity charge. For those on the *"Seaboard"* methodology, 50 percent of these fixed costs are in the commodity charge. For those on the "modified fixed-variable" methodology, the only storage- and transmission-related fixed costs in the commodity charge are return on equity and related income taxes. While these are the most common methodologies, they are by no means the only possible ones. *See* Natural Gas Pipeline Company of America, 25 FERC ¶ 61,176 (1983).

unable to make up the lost volumes by selling the excess supply elsewhere, it may file new rates to offset the decreased sales. In these new rates, the pipeline's fixed costs will be spread over the lower volumes the pipeline expects to sell, resulting in higher rates on that system. Although the higher rates will apply to all customers, the captive customers have no alternative to paying these rates, at least in the short run, while the swing customers (absent a minimum commodity bill) can avoid higher commodity charges. Thus the tension exists.

B. *The Traditional Functions of Minimum Commodity Bills*

From the above explanation, it can be seen that minimum commodity bills have traditionally served several functions. First, they have protected pipelines from the risk of under-recovering fixed costs in the commodity component of rates, up to a particular level. As such, they have acted as a kind of additional demand charge. Second, they have protected full requirements customers from having to bear an unbounded portion of fixed costs resulting from swings off the system by partial requirements customers. Third — and this third function is actually an outgrowth of the second — minimum bills have been recognized as protecting all customers from increased "take-or-pay" costs that may otherwise be incurred by the pipeline.

C. *Take-or-Pay Recovery*

In recent years, when pipelines have contracted with producers to purchase natural gas, they have tended to agree to contracts with "take-or-pay" clauses. Under these clauses, the pipeline agrees that it will take a particular level of gas from a supply source (usually a certain percentage of reserves or annual

deliverability) or pay for that level of gas anyway.[15] If the pipeline's sales fall off, it may be find itself unable to take enough gas to meet its contractual take-or-pay obligations. When that happens, it may be required to make annual take-or-pay payments to its producer suppliers. Any such payments, if prudently incurred, are eligible to be placed in the pipeline's rate base, and the associated carrying charges, usually in the form of return and related income taxes, thus become a fixed cost on that system.[16]

Therefore, if a partial requirements customer significantly decreases its purchases in order to swing to a lower-cost pipeline, there may be take-or-pay liability associated with the gas not taken. If the pipeline is unable to make up this liability over the course of its contract year with the producer, it may actually incur take-or-pay payments, causing its costs to go up. In this manner all customers will feel the effect of the decreased purchases. Minimum commodity bills, which discourage swinging, can therefore be said to perform the function of helping to prevent take-or-pay costs on some pipeline systems.

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[15] Take-or-pay clauses generally have make-up rights so that the pipeline can later take delivery of any gas it paid for but did not actually take. A general discussion of the reasons for take-or-pay clauses and the Commission's policy on same can be found in "Take-or-Pay Provisions in Gas Purchase Contracts," Statement of Policy, FERC Stats. and Regs., Regulations Preambles ¶30,410 (1982). (Makeup rights with respect to minimum bills are discussed in this rule at Part VII, *infra*.)

[16] Gas prepayments are recorded in an Asset Account (No. 165) and are generally included in rates only through a section 4 rate proceeding. Representative levels of prepayments are included in the Working Capital component of rate base, but the prepayment amounts are not recovered as a part of amortization or depreciation. This treatment compensates the pipeline for the carrying costs associated with making the prepayments, but makes recovery of the principal dependent upon make-up of the prepaid gas volumes.

D. *Variable Cost Recovery*

As a final note to this summary of the traditionally-argued justifications for minimum commodity bills, it should be recognized that all of the above discussion relates to recovery of *fixed* pipeline costs. The recovery of *variable* costs via minimum commodity bills were simply not an issue in the past. This is because interstate pipelines generally were buying all the gas they were offered (*see* discussion *infra*) and because the major variable cost — the gas supply itself — represented a far smaller proportion of the total minimum commodity bill than it does today.[17] Any potential recovery of unincurred variable costs via a minimum commodity bill was incidental to the issues traditionally surrounding fixed cost recovery.

For reasons explained below, there has been a recent shift in the role played by variable costs, a shift that necessitates a new look at the functions of minimum commodity bills.

E. *Recent Changes in the Natural Gas Industry*

Dramatic changes have occurred in the natural gas industry since passage of the Natural Gas Policy Act of 1978 (NGPA).[18] These changes call into question whether, regardless of the traditional reasons for minimum commodity bills, such provisions are acceptable today.

Until December 1978, the regulated wellhead price of gas in the interestate market kept the burner-tip price generally below that of alternative fuels. This made gas a desirable energy source, and a major problem facing interstate pipelines and their customers was ensuring a sufficient supply to meet demand. In

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[17] As the Notice in this docket reported (at p. 32,671), the average wellhead price of gas in 1955 was $.10/Mcf, or approximately 40 percent of the pipeline's delivered cost to the city gas (point of resale to distributors). By 1983, the average purchased gas cost of the Major Class A and B pipelines were $3.08/Mcf, or almost 75 percent of the average city gas price.

[18] 15 U.S.C. § 3301, *et seq.*

part to alleviate this supply problem, Congress enacted the NGPA, which established a schedule for gradually deregulating wellhead prices and set higher ceiling prices for a number of categories of gas. This legislation had the intended effect: it increased exploration for and development of natural gas supplies. Pipelines, for reasons set forth in detail in the Commission's Notice, began to enter into long-term gas purchase contracts that reflected the new, higher ceiling prices and certain other non-price concessions designed to increase their bidding power. Among these concessions were high take-or-pay requirements. Within a few years of passage of the NGPA, the average cost of gas had risen markedly on most pipeline systems.

At the same time, however, the nation was experiencing a substantial and extended economic downturn. This development, combined with higher gas prices, led to a significant drop in industrial purchases of natural gas. It also led to strong and unanticipated conservation efforts by industries, commercial concerns and homeowners, further lowering the demand for gas. In addition, as gas prices rose, gas began to lose its market share to alternative fuels in some areas. The price of oil declined and oil supplies became increasingly available. The convergence of these factors has resulted in the current deliverability surplus of natural gas, much of which surplus is governed by contracts containing take-or-pay requirements. The surplus was further exacerbated on some systems by reduced space heating demand due to unusually mild weather and on other systems by competition from increased hydroelectric power.

This situation has left the industry in a difficult position. As one commenter put it, citizens and their representatives have observed this continuing oversupply, and at the same time have observed significant and steady increases in natural gas prices, at least until recently. This set of phenomena has led members of the public to question whether gas markets are responsive to traditional theories of supply and demand.

To the extent that gas markets are not responsive, it is due at least in part to the failure of price signals to flow from the burner tip to the wellhead. Many commenters have observed that a major obstacle to the transmittal of price signals is the existence of pipeline minimum commodity bills.

IV. *Analysis of the Rule*

A. *The Basic Issue*

Section 4 of the Natural Gas Act requires the Commission to ensure that jurisdictional pipeline rates and charges are "just and reasonable." Section 5 requires that whenever the Commission finds that any rate or charge is "unjust, unreasonable, unduly discriminatory, or preferential," it shall act to remedy that rate or charge.

This rulemaking considers whether the collection of variable costs via a minimum commodity bill represents a just and reasonable rate or charge under sections 4 and 5 of the Natural Gas Act.

B. *The Effect of Minimum Commodity Bills in the Post-NGPA Era*

Since passage of the NGPA, gas prices have risen to the point that purchased gas costs make up the majority of a pipeline's variable costs and hence its commodity rate. As a result, two significant new functions are now being performed by minimum commodity bills. First, minimum commodity bills have become a vehicle by which enormous purchased gas "costs" can be collected even if the pipeline never actually incurs such costs. Second, minimum commodity bills have become a major obstacle to the transmittal of clear market signals from the burner tip back to the wellhead.

1. *Minimum Commodity Bills Can Result in Collection of Costs Not Incurred*

It is an initial tenet of the ratemaking process that rates should reflect cost incurrence. *Carolina Power and Light Company*, 4 FERC ¶61,107 at 61,232 (1978); *Indiana & Michigan Electric Co.*, 10 FERC ¶61,238 (1980); *Connecticut Light & Power Co.*, 14 FERC ¶61,139 (1981). Only costs that are necessary and reasonably incurred in providing gas service can be charged to ratepayers under the Natural Gas Act. *Midwestern Gas Transmission Co.*, 36 F.P.C. 61, 70 (1966), *aff'd, Midwestern Gas Transmission Co.* v. *F.P.C.*, 388 F.2d 444 (7th Cir. 1968), *cert. denied*, 392 U.S. 928 (1968).

By definition, there are no variable costs incurred for volumes not purchased for resale. Accordingly, a minimum commodity bill that includes variable costs gives a pipeline the right to collect for "costs" it has not in fact paid out to provide jurisdictional natural gas service. On its face then, a minimum bill that permits such "cost" collection is unjust and unreasonable.

A great many commenters expressed this conclusion. Some provided figures setting forth the variable costs they could potentially incur in current and future periods for gas they cannot take because they have no market for it. These costs are considerable.[19] Another commenter noted that it had recently

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[19] For example, Consumers Power Company states that the latest rate filing of its major supplier (Trunkline Gas Co.) indicates that Consumers will fall some 58,880,000 dekatherms below minimum bill volumes. Consumers and Trunkline have worked out a settlement on the minimum bill problem. Absent this settlement, however, Consumers would have had to pay approximately $251,000,000 in minimum bill charges for gas not taken. "That extravagant sum," notes Consumers, "would be pure profit to Trunkline's stockholders, since the variable costs actually incurred by Trunkline with respect to the volumes not taken would be zero." Consumers states that the Trunkline settlement expires after 1984, so that the minimum bill issue has not gone away. (Trunkline's Reply Comments assert that without the minimum commodity bill obligation, its customers will be "free to ignore" the commitments

invoked *force majeure* in an effort to suspend its supplier's minimum commodity bill because of an inability to take at the established level. A state commission pointed out that variable costs in minimum commodity bills discourage and penalize energy conservation efforts because they require distributors to pay for supplies that are not longer needed due to the conservation efforts of their customers. Why conserve gas, a commenter asked, when you must pay for it whether you take it or not. Another commenter stated that potential collection of costs not incurred "defies common sense."

Further, to the extent that minimum commodity bills compel payment for a certain amount of gas even when the customer cannot take it, they provide an artificial market that fails to convey signals through the interstate pipeline that demand is reduced. Failure to convey this signal may encourage producers and pipelines to continue contracting for gas at the same or higher prices. (This issue is discussed at length *infra*.)

No commenters really took issue with the above statements. Instead, those favoring retention of variable costs in minimum commodity bills made two other arguments. First, they argued that collection of these "costs" is necessary to cover any take-or-pay payments that might come about if a customer takes below its minimum commodity bill level. The Commission rejects this argument for reasons explained *infra* in its discussion of responsibility for take-or-pay.

Second, some commenters asserted that if the Commission's real concern is simply the elimination of potential windfall profits to pipelines, there are other ways of accomplishing this objective. They suggested that to the extent a pipeline recovers variable costs not actually incurred, it simply be required to

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the pipeline has made to meet its full contract quantities. This argument is considered *infra*.)

credit those sums (presumably with interest added) back to customers through Account No. 191.[20]

In fact, the Commission has adopted such an approach in several cases where it was faced with the overcollection problem.[21] It must be noted, however, that this approach is flawed. Amounts credited to Account No. 191 flow back to the system as a whole, not to individual customers. Thus, the customer paying for the unincurred "costs" will recieve only a percentage of these "costs" back again. This means that a customer is not actually relieved of the variable costs in its minimum commodity bill. It still has to come up with the cash to pay the total amount, its only comfort being that with the pipeline's next PGA filing a portion of those payments will be returned to it in the form of lower gas costs systemwide.

The Commission finds that this collection/crediting device can result in unduly discriminatory and preferential rates. Unincurred "costs" can be collected from certain customers and later, through crediting, shared with other customers.[22] Any matching of collections and credits may be purely coincidental. Indeed, those customers not making minimum commodity bill payments would receive a pure windfall.

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[20] Account No. 191 records Unrecovered Purchased Gas Costs. Credits to this account thus offset the systemwide cost of purchased gas. Pipelines reconcile their Account No. 191 balance against their actual revenues each time they make a purchased gas adjustment (PGA) filing. For most pipelines, the PGA is filed every six months. *See* 18 C.F.R. § 154.38(d)(4).

[21] *See* El Paso Natural Gas Co., 22 FERC ¶61,358 (March 31, 1983). Transwestern Pipeline Co., 24 FERC ¶61,009 (July 8, 1983).

[22] In some instances a customer might not have any of these "costs" returned at all. For example, a customer may purchase little or no gas from a pipeline during certain periods. If that customer pays for unincurred "costs" during period A but the crediting back of these "costs" occurs during period B, the customer will receive some benefit only to the extent it is purchasing from the pipeline during period B.

In addition, under the pay-now/get-credit-later scheme, a customer will not know the true effect of minimum bill payments (in terms of payment versus credits) until after the fact. This does not allow for fully informed and effective decision-making by a pipeline customer at the time it schedules its gas purchases.

Further, even if the Account No. 191 mechanism were an appropriate means of preventing windfall profits, this mechanism would not relieve the Commission of all its concerns. As will be discussed *infra*, a related concern is the role minimum commodity bills play as a restraint on competition. This concern would not be alleviated by use of the proposed Account No. 191 mechanism.

In sum, based on the applicable legal standards and on the record with respect to the question of recovery of variable costs not incurred, the Commission finds that to the extent minimum commodity bills permit the recovery of such costs, they are unjust and unreasonable under the Natural Gas Act.

2. *Minimum Commodity Bills Act as a Restraint on Competition*

While many commenters did address the above-discussed cost recovery issue, the bulk of the comments in support of the rule went to the restraint-on-competition issue. These comments stated that the presence of variable costs in minimum commodity bills creates serious market distortions, insulates pipelines and producers from price signals, hinders competition, and prevents pipelines and distributors from pursuing a least-cost purchasing strategy.[23] These effects occur because partial requirements customers cannot purchase lower cost gas supplies if they are required to pay for the higher-cost gas they do not take. One pipeline described the situation as being "coerced"

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[23] Many of these commenters recommended total elimination of minimum bills rather than elimination of variable costs only. This question is separately considered at Part VII *infra*.

into purchasing gas from a pipeline supplier in lieu of other, cheaper sources.

In support of these general comments, a number of commenters provided data demonstrating how their own system costs have been or could be reduced via removal of variable costs in their minimum commodity bills. The Commission is further convinced by these data that the presence of variable costs in a minimum commodity bill constitutes an unjust and unreasonable rate or charge and is contrary to the public interest. This decision is based on the following factors.

a. *Variable Costs in Minimum Commodity Bills Insulate Pipelines and Producers From Market Risk and Thus Inhibit Decreases in Price*

The comments filed in this docket make it clear that the presence of variable costs in minimum commodity bills blocks proper communication among producers, pipelines, distributors, and ultimate consumers.[24] When distributors and pipelines are required to purchase gas under a minimum commodity bill, even when less expensive sources are available, the supplier pipeline can continue to operate profitably without having to worry about keeping its gas costs at a reasonable level. Thus, minimum commodity bills result in gas prices being "propped up," as one commenter put it, at levels higher than the market would otherwise support.[25]

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[24] The Commission has already recognized this problem in several individual cases. *See* Tennessee Gas Pipeline Co., 21 FERC ¶61,004 (1982); United Gas Pipe Line Co., 21 FERC ¶61,283 (1982).

[25] One state commission put it more strongly, saying minimum bills violate the antitrust policy of the United States. *See* comments of State of Michigan and the Michigan Public Service Commission.

Removal of the insulating minimum commodity bill, on the other hand, places much of the risk of market loss on the pipeline. This risk creates an incentive for the pipeline to go back to its producers and convey the message that its customers will not buy gas, or will buy less gas, at such a high price.

One commenter notes that removal of the insulation factor should also give pipelines more leverage in their negotiations with producers. It may be difficult to argue the need for lower prices or reduced take-or-pay when the producer knows that automatic minimum commodity bill recovery of most gas costs is provided.[26] Removal of such automatic recovery should alter the bargaining situation and result in lower prices for natural gas.

Further, in an unregulated market, sellers who are willing to accept a price that is below the prevailing price are generally able to increase their sales volumes. By the same token, buyers may be able to offer to increase their purchases if sellers will accept reduced prices. This ability to exchange price concessions for increased sales volumes is essential to the efficient functioning of a price responsive market.

But including variable costs in minimum commodity bills prevents this exchange. A pipeline cannot offer to buy more gas from a producer that lowers its prices if that pipeline's customers are under minimum commodity bill obligations elsewhere. Thus, mimimum commodity bills can act to deprive producers of the opportunity to increase sales volumes in exchange for accepting a reduction in price.

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[26] For example, one pipeline that does *not* have a minimum bill states that for this reason it has had to maintain competitive prices, and that its prices are among the lowest of major pipelines. It adds, however, that it could have picked up other sales due to its low prices, but its customers could not buy due to their minimum bill obligations to other suppliers. *See* comments of Natural Gas Pipeline Co. of America.

The Commission therefore finds that utilization of mimimum commodity bills to recover costs for gas not taken is fundamentally inconsistent with the increasingly competitive wellhead market mandated by the Congress in 1978. Congress intended that there be an opportunity for gas prices to increase or decrease—whichever the market demands. Implementation of the instant rule will further this Congressional intent by removing one obstacle that inhibits response to market demand.

b. *Variable Costs in Minimum Commodity Bills Prevent Purchasers From Pursuing A Least-Cost Purchasing Policy*

During this period of sharply-increased gas costs, pipelines and distributors are attempting to pursue a least-cost gas purchasing policy, and some states have mandated such an approach.[27] This Commission has encouraged regulated utilities to pursue least-cost strategies in Order No. 298, 48 *Fed. Reg.* 24323 (June 1, 1983) and Opinion No. 186, 24 FERC ¶ 61,299 (1983).

As noted above, the presence of variable costs in minimum commodity bills thwarts this policy since it forces purchasers to take higher gas when lower priced gas is available.[28]

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[27] *See* comments of State of California and California Public Utilities Commission.

[28] For example, Philadelphia Electric Co. (PECO) and Philadelphia Gas Works (PGW) are distributors supplied by two pipelines, Texas Eastern Transmission Corp. (Tetco) and Transcontinental Gas Pipeline Corp. (Transco). PECO/PGW state that at the time they filed their comments, Transco's full commodity charge was $3.679/dth. At the same time, Tetco had available interruptible gas at a total charge of $2.9528/dth, or about 73¢/dth less. Transco and its customers negotiated a settlement under which purchased gas costs were removed from its mimimum bill, resulting in a mimimum commodity bill of only $0.32. Thus, PECO/PGW were in a position to pay Transco's mimimum commodity bill, yet buy gas from Tetco, saving money for their customers. This example demonstrates how removal of variable costs from minimum bills

c. *Variable Costs in Minimum Commodity Bills Lead to Loss in the Industry As A Whole*

The propped-up high price of natural gas creates an incentive for large industrial and commercial customers of distributors to switch to lower-cost alternate fuels.[29] Comments from distributors indicate that they do not have mimimum commodity bills in their state-regulated rates, leaving their customers free to switch to other fuels. The resulting lead losses place greater and greater fixed cost responsibility on the remaining residential and small commercial customers.

A further point was made in this regard by one commenter. When load is lost due to high price, the price that undercuts the gas is usually that of fuel oil. Increased use of fuel oil may be detrimental to the national interest since it increases dependence on foreign oil supplies.

d. *The Traditional Justification for Minimum Commodity Bills Do Not Compel Variable Cost Recovery*

Several commenters point out that the three traditional justifications for minimum bills described *supra* (fixed cost recovery, equitable cost recovery, take-or-pay recovery[30] are linked to the traditional rate design methodologies that have generally been applied to interstate pipelines. Those rate design methodologies (*"United"* and *"Seaboard"*[31] respectively recover only 25

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can permit purchasers to pursue a least-cost policy resulting in a significant savings.

[29] Many large users installed alternative fuel capability during the 1970's when gas curtailments were frequent. These users often have the ability to switch to fuel oil on only a few hours notice. *See* U.S. Energy Information Administration, The Natural Gas Market Through 1990 (Part IV of An Analysis of the Natural Gas Policy Act and Several Alternatives) (May 1983) at 31.

[30] Further detailed discussion of the three traditional justifications for minimum commodity bills is set forth at p. 32,669 of the Notice.

[31] *See* n.14, *supra* at 7.

percent or 50 percent of storage and transmission related fixed costs in the demand rate. Thus minimum commodity bills have traditionally been a device for ensuring some minimum degree of *fixed* cost recovery through the commodity rate. The commenters note that this was particularly important during periods when pipelines were making large expenditures for construction of facilities needed to meet new demands, and fixed costs represented the majority of pipeline costs.[32]

Today, however, most pipelines are not in this situation. Very little overall increase in demand is occurring. Major gas supply facility expenditures once made by existing pipelines are now generally made by newly certified pipelines utilizing special approaches such as project financing. (Project-financed pipelines are discussed separately at Part VII *infra*.) In response to the current market, pipelines and the Commission have been moving away from "*United*" and "*Seaboard*" in the direction of unloading the commodity charge by utilizing a "modified fixed-variable"[33] rate design.[34] This approach permits recovery of more fixed costs in the demand charge and diminishes much of the formerly perceived need for minimum commodity bills.

Not all pipelines, of course, currently utilize the modified fixed-rate variable rate design, nor does the Commission at this time find it necessarily appropriate for all pipelines. But even for those with more fixed costs at risk, the rule adopted herein does not represent a departure from the traditional use of the

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[32] *See* Hooley, R., *Financing the Natural Gas Industry*, Columbia University Press, 1961.

[33] *See* n.14, *supra* at 7.

[34] *See* Natural Gas Pipeline Company of America, 25 FERC ¶61,176 (1983), *reh'g denied*, 26 FERC ¶61,209 (1984). The Commission has also approved several settlements in the past year that incorporate a modified fixed-variable type of rate design. Commission approval of a settlement does not necessarily equate with adoption of its individual components, but these settlements are indicative of a trend in the industry.

minimum commodity bill to ensure greater fixed cost recovery. Only *variable* costs are removed from the minimum bill under the rule. Prudently incurred fixed costs continue to be recovered at whatever level the minimum commodity bill provides.

To the extent that the traditional justifications are also related to shifting of fixed costs among customers and to potential take-or-pay exposure, the Commission finds that these factors do not justify the use of minimum commodity bills to collect gas costs in today's market. The reasons for this conclusion are set forth *infra* under the discussion of "Effects on Full Requirements Customers."

e. *Recovery of Variable Costs in Minimum Commodity Bills Violates the Mandate of the Natural Gas Act*

The Commission has a basic mandate under the Natural Gas Act to protect consumers from excessive rates and charges. *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944). To this end, the courts have recognized that economic efficiency and greater competition in the industry are appropriate goals for the Commission to pursue. *Atlantic Seaboard Corp* v. *FPC*, 404 F.2d 1268, 1272 (D.C. Cir. 1968). *See Central Illinois Light Co.* v. *Panhandle Eastern Pipeline Co.*, 21 FERC ¶ 61,147 (1982); *State of Michigan* v. *Trunkline Gas Co.*, 20 FERC ¶ 61,100 (1982).

Indeed, it has been made clear that fostering competition is not only an appropriate goal but must take a high priority in the values which the Commission considers when it determines whether rate structures are just and reasonable. *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973); *Lynchburg Gas Co.* v. *FPC*, 336 F.2d 942 (D.C. Cir. 1964).

Recently speaking to the importance of competitive considerations in *City of Florence* v. *Alabama-Tennessee Gas Pipeline Co.*, 24 FERC ¶ 61,395 (1983), the Commission observed:

> Congress and the courts have agreed that competition has a role even in a regulated industry such as the natural gas industry. If competition exists, incentives are created for innovation by the regulated companies. This, in turn, encourages lower prices and better services. (Citation omitted.) In short, competition can, and should, complement our regulation of the natural gas industry. 24 FERC at p. 61,839.

The record in this docket establishes without question the anti-competitive effects of collecting variable costs in minimum commodity bills. Further, the record does not demonstrate that other considerations are so compelling that the Commission must overlook these anti-competitive effects. Accordingly, based on the mandate of the Natural Gas Act, the relevant legal precedent, and the record before it, the Commission finds that variable costs in mimimum commodity bills represent unjust and unreasonable rates or charges.

3. *Arguments In Opposition To the Rule Are Not Compelling*

If, as one commenter stated, it is "difficult to envision a provision more anticompetitive and less in the public interest" than a minimum commodity bill, why is there opposition to the proposed rule? In fact, there is strong opposition from many commenters. Their arguments are as follows:

a. *The Two-Way Street*

A number of commenters took the position that the proposed rule, because it would change the economic relationship between pipelines and customers, would amount to a "basic restructuring of the industry." They pointed out that the pipeline-distributor relationship has always been a "two-way street," with the obligation to provide the gas on one side, and the obligation to buy it on the other. The proposed rule would present more of a "one-way street" in that the pipeline would still be expected to stand

ready with the supply, but some customers would be free to swing off and on the system at will.

For these reasons, it was argued, the removal of variable costs from minimum commodity bills would fundamentally alter one of the premises upon which planning in the natural gas industry is structured. The Commission should not take such an action, another commenter stated, without giving pipelines some other vehicle by which they can reasonably plan their purchases of natural gas.

The two-way street argument was discounted by other commenters, one of whom termed it a "strawman." These commenters responded that the *quid pro quo* for a pipeline's obligation to render service is the demand charge. Customers pay a demand charge regardless of whether or not they buy gas. Under modified fixed-variable rate designs, the demand charge recovers *all* storage and transmission fixed costs except return on equity and related income taxes.[35] Thus the pipeline, in exchange for standing by to render service, is compensated for nearly all of its fixed costs. Whatever fixed costs are not guaranteed represent the risk of doing business.

It was observed by other commenters that the two-way-street, mutuality-of-obligation theory was more illusory than real. These commenters pointed out that minimum commodity bills are inequitable in light of a lack of concommitant obligation on the part of the pipeline seller. This, they argued, is because pipeline curtailment plans generally permit curtailment without penalty when gas supply is insufficient. Given this lack of obligation to serve when gas is scarce, they asked why customers should be obligated to buy when gas is plentiful.

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[35] These latter items represent the pipeline's profit; it is generally accepted that they should be at risk in order to give the pipeline some incentive to keep its gas marketable. If *all* fixed costs were in the demand component, the pipeline could earn a profit without selling a single Mcf of gas.

The commenters further pointed out that the need for gas supply planning should not come at the expense of competition. They conceded that it is undoubtedly easier to plan a gas purchasing strategy when one is assured of a given level of sales. On the other hand, they noted that it does not seem unthinkable that a pipeline plan its purchases by taking into account its competitive position vis-a-vis other pipelines and alternate fuels. The Commission agrees on this point. It also recognizes that the lack of a minimum commodity bill may indeed require more flexibility than some pipelines have become accustomed to. The Commission believes this may lead to new and creative approaches to gas purchase contracts.

Another consideration raised with respect to the two-way street theory is responsibility for any take-or-pay costs the pipeline could incur due to inability to estimate how much gas it will need to purchase. All issues related to the take-or-pay question are discussed separately at Part V *infra*.

Finally, to the extent that the rule may shift certain risks, alter approaches to planning, and allow for more competition in the industry, the Commission agrees with the commenters who observed that the rule will "restructure" traditional ways of conducting pipeline business. Ultimately, however, these commenters must recognize that it is not this rule that is "restructuring" the natural gas industry. The restructuring that has been, is, and will be taking place — with or without this rule — is the unavoidable outgrowth of the wellhead deregulation process that the Congress began in 1978. The Commission is simply adapting its regulations to reflect the realities of that process.

The Commission recognizes that change is difficult, particularly in an institutionalized structure such as the natural gas industry, but regulatory policy cannot remain static in the face of both Congressional action and significant changes in the nation's economy. The changes that have occurred since the NGPA cannot be ignored or (absent Congressional action)

undone. Rather, the Commission must move forward and deal with matters as they exist today. This rule represents part of that movement.[36]

b. *Effects on Full Requirements Customers*

Many commenters raised another major issue in opposition to the rule. They noted that natural gas pipelines rely on the estimates of *all* of their customers as the basis for contracting to purchase natural gas. If a partial requirements customer estimates a particular level of need, that need will be taken into account when the pipeline enters into gas purchase contracts. Yet, if that customer is not obligated (via a minimum commodity bill) to purchase gas every month, it may swing to another supplier. Its departure from the system (even though it continues to pay a demand charge and to retain its right to return to the system[37]) could have a detrimental effect on the remaining customers in several ways.

First, if the pipeline incurs take-or-pay payments as a result of the downturn in its sales, the pipeline may seek to carry these costs in its rate base. Under traditional ratemaking treatment, the costs would be considered production-related and thus assigned to the pipeline's commodity charge.[38] In this manner, the remaining customers could end up assuming a larger cost burden in the form of increased fixed costs in their commodity

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[36] The Commission has taken a number of other actions that reflect the changing face of the industry. *See, e.g.,* Take-or-Pay Statement of Policy (n.15, *infra* at 9); the Off-System Sales Statement of Policy (23 FERC ¶ 61,140 (1983); the Blanket Certificate Rules (FERC Stats. and Regs. ¶ 30,476; 30,477 (1983)); the Special Marketing Program orders (*e.g.,* Transcontinental Gas Pipe Line Corp., *et al.,* 25 FERC ¶ 61,219 (1983) and 26 FERC ¶ 61,029 (1984)); and the recent Notice of Inquiry on the Impact of Special Marketing Programs (FERC Stats. and Regs. ¶ 35,513 (1984)).

[37] Indeed, the pipeline could not abandon a certificated service to the customer absent Commission approval.

[38] *See* n.14, *supra* at 7 and n.16, *supra* at 10.

charge. Further, the remaining customers might have to continue carrying a share of any take-or-pay related costs that resulted from the pipeline's maintaining enough gas supply to meet its standby obligation to the swing customer. Finally, if the pipeline acted to decrease its purchased gas commitments to producers, take-or-pay might be reduced, but another problem could arise. Should there be a curtailment situation, during which the partial requirements customer came back to the system and demanded its full entitlement again, available gas would be allocated among *all* customers[39] and there might not be enough to serve the needs of the full requirements customers who stayed on the system all along. Thus, argue many pipelines and full requirements customers, there could result significant harm without a minimum commodity bill. In sum, the commenters who oppose the rule fear that if the pipeline buys too much gas, full requirements customers may suffer increased costs; if it buys too little gas, full requirements customers may face curtailments.

These arguments make some valid points. Initially, there may be some cost shifting and take-or-pay cost increases on systems that lose partial requirements customers to cheaper suppliers. At the same time, however, these swing customers, once relieved of the variable cost portion of their minimum bill, may purchase gas from a lower-priced pipeline. As the latter pipeline's sales increase, it can be expected that there will be benefits to *its* full requirements customers in terms of lower take-or-pay payments and higher volumes over which to spread fixed costs. Thus, viewed from a national perspective, the rule may create offsetting benefits and detriments to captive customers, depending on

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[39] Curtailment priorities established in the NGPA require that gas be distributed according to its end-use, with residential use coming first, and so forth.

whether they are served by a high-cost or a low-cost pipeline.[40] This national perspective, however, is small comfort to customers of a high-cost pipeline. To these customers, the Commission would observe the following.

First, if a high-cost pipeline loses load, the pipeline itself will be the first to feel the impact. Any increased costs it experiences are not automatically passed on to customers. Rather, the pipeline must prepare and file a new rate case with the Commission, which has 30 days in which to act on the filing. The Commission suspends most major rate cases for five months, the maximum period permitted under the Natural Gas Act. This means that for a period approximating six months, the pipeline itself carries any increased costs resulting from load loss. Thus pipelines are not indifferent to the loss of a swing customer and should be motivated to prevent such losses or, if they occur, to renegotiate take-or-pay liability.

Next, in its rate filing, the pipeline must demonstrate that the filed rates are just and reasonable under the Natural Gas Act. At this point captive customers will have an opportunity to argue that the new take-or-pay costs should not be recovered by the pipeline because they are the result of imprudent purchasing practices that led to high gas costs on the pipeline's system. These high gas costs, in turn, led the partial requirements customer to swing to another source of supply. The Commission expects that a high-cost pipeline, aware that this argument will be made, would again be motivated to renegotiate both prices and take-or-pay levels with its producer suppliers in order to regain the lost load. Thus, after a period of adjustment and renegotiation, the price of gas should go down, the load should be

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[40] The Commission notes that a pipeline's "lower cost" status may not necessarily be the result of management efficiency but may instead result from gas supplies that were "locked in" at a low price by the NGPA. This rule should give higher cost pipelines an opportunity to compete with lower cost pipelines by providing them with leverage for renegotiation with producers selling high-cost supplies.

regained, and the level of take-or-pay costs on the system should decline. Any decline in price of gas would be reflected in the pipeline's next PGA filing,[41] while other changes would be reflected in the next rate case.

Second, as some comments note, to the extent a pipeline loses sales as a result of its inability to meet competition, its allowed return on equity may have to be adjusted, a possibility the Commission has already acknowledged. *Tennessee Gas Pipeline Co.*, 21 FERC ¶ 61,004 (1982). In this situation, fixed costs to all customers would be reduced in the rate case.

Third, it is noted that if a pipeline files new rates to reflect increased take-or-pay costs, it cannot be assumed that these costs will automatically be allocated among its customers on the same basis that other costs are allocated. The question of appropriate allocation of take-or-pay costs is discussed in detail *infra*.

Finally, the Commission recognizes that while pipelines have a public service duty, they are also in business to make money. If their cost of service has been properly established, the only way they should be able to recover their allowed return on equity is by selling all the volumes upon which their rates are designed. (A minimum bill that recovers fixed costs may guarantee this recovery up to a certain level.) The only way they should be able to exceed their allowed return is by selling more gas than the volume upon which their rates are designed. Thus, pipelines have an incentive — indeed have a duty to their shareholders — to maximize sales. Given this situation, pipelines will be unable simply to ignore the loss of a swing customer. Rather, the Commission expects pipelines to make vigorous efforts to compete in the market, which efforts should result in proper transmittal of price signals and lower prices for natural gas.

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[41] In some cases, the Commission has permitted out-of-cycle PGA filings to enable pipelines to reflect decreased prices on an expedited basis.

Accordingly, while this rule may result in short-term shifts in markets that could be detrimental to some customers, in the long term there should be benefits to all customers of all pipelines as the industry moves towards a competitive balance.

The final matter with respect to the rule's effect on captive customers is the above-mentioned curtailment issue. Some commenters raised the spectre that if lower-priced gas is available, a swing customer will leave the system absent a minimum commodity bill, and the pipeline will then either have to incur take-or-pay costs or adjust its gas supply requirements downward. If it chooses the latter course, its producer-suppliers will reduce their gas exploration and development efforts accordingly. Then, if a partial requirements customer returns to the system and demands its full contract entitlement, the pipeline will not have sufficient deliverability available to meet demand and will have to curtail. Supplies will be allocated among all customers and those who stayed on the system all along will be unable to get the gas they need.

While this scenario may appear plausible at first glance, it bears further scrutiny. If a customer swings to a lower-cost pipeline as a result of this rule, that lower-cost pipeline will, using the same logic, adjust its gas supply requirements upward. This, in turn, will lead to increased exploration and development by *its* producers. In other words, while swinging potentially could lead to reduced activities by some producers (those selling expensive gas), it could also lead to increased activities by other producers (those selling cheaper gas). Thus, it seems unlikely that this rule could lead to a nationwide shortage of gas. If anything, the opposite effect is likely, as noted earlier. To the extent, however, that swinging could create shortages on a particular system under particular circumstances, emergency procedures are available for sales and transportation of gas from one pipeline system

to another to prevent curtailments.[42] The Commission believes that the circumstances described by the commenters are unlikely, however, in that this rule should help gas markets straighten out, thereby easing planning strategies.

In sum, the Commission has carefully considered the above-discussed concerns about the rule's effect on captive customers. It does not take these concerns lightly, and it acknowledges that on some systems the rule could cause temporary difficulties for these customers for the reasons discussed above. The Commission must, however, balance these potential difficulties — which it expects to be isolated and of short duration — against the benefits it expects the rule to produce: prohibition of collection of unincurred gas "costs"; removal of market constraints; greater competition; more accurate price signals to the wellhead; and increased quantities of lower-priced gas supplies, all leading to reasonable overall prices that can compete in the market. Given these public policy considerations, the Commission's finding that variable costs in minimum commodity bills are unjust and unreasonable is not altered by the comments in opposition to the rule.[43]

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[42] *See* 18 C.F.R. Part 157, Subpart C and § 157.210; Part 284. Further, the Commission has a number of regular transportation programs under which gas may be moved from system to system.

[43] In balancing the potential effects of the rule, the Commission also takes official notice of a recent report by the American Gas Association which found that over 80 percent of gas pipeline sales for resale are to distributors with other sources of supply, or to other pipelines. AGA Energy Analysis 1984-2, "Competition in the Natural Gas Industry" (February 14, 1984). While this analysis may overstate the extent of competition, (for example, the AGA Analysis does not discuss whether distributors get the bulk of their supply from a single pipeline and only a small amount from alternate sources), it is nevertheless an important indication that a great deal of pipeline load is susceptible to competition. This supports the Commission's finding that the rule will make it possible for potential competition to become reality. Such an event should eventually benefit even the captive customers of high cost pipelines.

C. *Scope of the Rule*

In its Notice, the Commission proposed a rule that would prohibit minimum commodity bills that recover "purchase[d] gas costs, fuel costs, or other variable costs . . . which are not actually incurred in rendering service." Notice at p. 32,674.

A number of commenters told the Commission that it had not been explicit enough as to what costs were to be removed from the minimum bill. They pointed out that most minimum commodity bill tariff provisions simply specify payment of a percentage of monthly contract volumes multiplied by the commodity charge. Fixed and variable costs are generaly not broken out, and there are no other figures in the tariff from which such a breakout can be calculated. Further, they noted that historically there has been uncertainty about whether certain compression and transmission costs are fixed or variable. Other commenters asked about the commodity portion of Account No. 858 (Transmission and Compression of Gas by Others) and the systemwide cost of service for total gas supply function expenses.

It was suggested that the rule would be more straightforward and easily administered if all commodity bills were required to be similarly structured. One commenter proposed that this be accomplished by simply requiring that purchased gas costs, which make up the vast portion of variable costs and are easily identified, be separately stated in each pipeline's tariff, and that recovery of such costs not be permitted for gas not taken.

The Commission has found the collection of variable costs via minimum commodity bills to be an unjust and unreasonable rate or charge. This finding must be implemented, however, in a manner that is clear and administratively sensible. As one commenter noted, it is important that pipeline customers be able to look at a tariff and know exactly what costs will or will not be incurred under the minimum bill. Armed with this knowledge, they will be able to evaluate the cost impact of purchasing from an alternate supplier.

The Commission recognizes that identification of variable costs other than purchased gas costs in the commodity charge may be difficult between rate proceedings. On the other hand, such identification can be performed by the parties and established routinely during the course of a rate case. Accordingly, the Commission is adopting the suggestion that the rule require purchased gas costs to be stated separately in all pipeline sales tariffs, and that recovery of purchased gas costs for gas not taken by the buyer be immediately prohibited on the effective date of the rule itself. The Commission defines "purchased gas costs" to include compressor fuel gas and line loss or shrinkage gas for purposes of the instant rule.

As for any remaining variable costs, the rule provides that they be isolated from fixed costs and eliminated from any minimum commodity charge in any pipeline rate case filed with the Commission after the effective date of the rule. Any differences of opinion as to whether the pipeline has properly performed this variable cost elimination can then be resolved in the course of the rate case.

In this manner, the unjust and unreasonable effects of minimum commodity bills that are identified in this rule will largely be eliminated immediately by the removal of purchased gas costs, while removal any of other variable costs will be accomplished over time in a reasonable and administratively efficient way. The Commission may eventually find it appropriate to address the handling of variable costs other than purchased gas costs generically after further study.

V. *Recovery of Take-or-Pay Costs*

Noted at several points in the foregoing discussion is the question of recovery of take-or-pay costs. Many commenters noted that pipeline contracts with producers typically contain take-or-pay provisions that require the pipeline to pay for a certain volume of gas even if the gas is not taken. Therefore, these commenters asserted, minimum commodity bills should be allowed

to recover gas costs in order to compensate for these take-or-pay costs, which are contractually required to be paid whether or not gas is taken. Put another way, these commenters would have the Commission characterize take-or-pay prepayments as "variable" costs that are "actually incurred" so as to remove them from the ambit of the rule as proposed.[44]

Opposing comments have convinced the Commission, however, that there is no clear nexus between a pipeline's annual take-or-pay obligations and its minimum commodity bills to its customers.[45] At the same time, there are compelling reasons for separating take-or-pay recovery and minimum bills.

First, commenters note that a pipeline may not necessarily incur any additional take-or-pay payments when a customer cuts back its takes below minimum bill levels. Clearly, in cases where no such payments are incurred, no gas costs should be recovered via the minimum commodity bill.

But, even in those cases where a customer's cutbacks below minimum bill levels do cause additional take-or-pay payments to be made, the commenters have not shown how the minimum commodity bill revenues collected from that customer would be used to compensate for the resulting associated carrying costs. Thus, it is unclear how remaining customers would be protected from increased rates. The Commission's experience with section 4 rate cases has been that pipelines seek to increase their rates to recover take-or-pay carrying costs independently of any consideration of minimum commodity bill revenue collections. Thus, existing minimum commodity bill revenue collections do not appear to accomplish the purpose that they are asserted to perform, *i.e.*, to compensate for take-or-pay. Rather, existing minimum commodity bills seem designed to prevent take-or-pay

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[44] Several commenters suggested methodologies under which they believe minimum bills and take-or-pay obligations could be linked.

[45] An exception to this finding may exist in the case of some Cost-of-Service pipelines, which are dealt with separately *infra* at Part VII.

prepayments from being incurred in the first instance, by discouraging customer cutbacks. This effect is, as noted earlier, anti-competitive, unjust, and unreasonable.

Further, it should be noted that prepaid gas can generally be made up. If the prepaid gas is in fact made up later, then the customers who actually take the gas should pay for it at that time. The Commission's decisions on pipeline rates have consistently followed this approach. The customer that cut back its takes should not necessarily pay for the prepaid gas.[46]

To summarize, customer cutbacks below minimum bill levels may not cause *any* take-or-pay costs. Second, even if take-or-pay payments do result from such cutbacks, existing minimum commodity bills generaly do not serve to compensate for the cost of the take-or-pay gas, and thus do not protect a pipeline's remaining customers from any resulting rate increases. Third, it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later. For these reasons, the Commission concludes that take-or-pay considerations do not justify including gas costs in a minimum commodity bill.

In addition, several commenters point out discrimination problems associated with take-or-pay recovery. They note that,

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[46] It is the Commission's understanding that most prepaid gas has, in fact, ultimately been made up. Indeed, no pipeline to our knowledge has yet permanently lost the right to take any prepaid gas because the make-up period expired. It is at least theoretically possible, however, that some pipelines may ultimately fail to take some prepaid gas before the make-up period expires. Should this occur, the question will arise as to who should pay for the unrecovered gas. That question is speculative and need not be addressed here. Meanwhile, it would be premature to require a customer taking below minimum levels in one year to pay for the gas costs on any resulting take-or-pay in that year, since the Commission could not know for several years whether that prepaid gas would ultimately be made up.

generally, not all of a pipeline's customers are subject to a minimum commodity bill. But, all customers are affected by conservation and economic downturn, which may cause load losses throughout the pipeline system. With respect to these overall economic effects, full requirements customers not subject to a minimum commodity bill may be as much responsible for take-or-pay payments as swing customers who are subject to a minimum commodity bill. Under these conditions, all customers should absorb a fair share of the pipeline's take-or-pay liability. But if the pipeline is permitted to "cover" its take-or-pay costs via minimum bill charges, the customers subject to a minimum commodity bill will bear a disproportionate burden of the pipeline's take-or-pay obligations. Such a result is inequitable. When the system as a whole cannot keep load factors high, swing customers should not be required to subsidize captive customers for take-or-pay costs.

While the Commission has found no justification for including gas costs in the minimum bill on the basis of take-or-pay liability, the record in this docket does indicate that take-or-pay carrying costs may require special consideration with respect to their allocation among jurisdictional customers when rates are designed. Commenters note that if a pipeline incurs take-or-pay payments as a result of a particular customer's cutbacks, that pipeline may subsequently be allowed to recover the carrying costs on those prepayments in its rates.[47] (Those carrying costs in any one year would be only a fraction of the actual cost of the prepaid gas.) Opponents of the rule argue that no customer

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[47] The Commission's regulations provide that a cost of service allowance for take-or-pay prepayments shall be based on the average of 13 monthly balances for a 13-month period ending no later than the end of the test period upon which the rate filing is based. 18 C.F.R. § 154.63(f). Through this methodology a take-or-pay level can be placed into rate base with the assurance that it is reasonably related to what the pipeline will actually experience. Tennessee Gas Pipeline Co., 26 FERC ¶ 61,102 (1984); Northwest Central Pipeline Corporation, 26 FERC § 61,247 (1984).

should be forced to pay part of those carrying costs to the extent that they were caused by another customer's cutbacks.

The Commission is somewhat sympathetic to this line of reasoning. There may be some justification for requiring prepayment carrying costs to be paid by certain customers if it can be demonstrated that their cutbacks caused the prepayments. No conclusion is reached on this point today; the matter requires further investigation. Accordingly, the Commission encourages its Staff to consider in individual rate cases whether and under what circumstances take-or-pay carrying costs should be allocated separately from other costs. The Staff's recommendations to the Commission in each case should consider all of the above-discussed factors, as well as any other factors Staff or the parties believe to be relevant.[48]

In sum, the Commission finds that the record supports a finding that incurrence of take-or-pay is not necessarily related to whether or not a customer takes gas at minimum commodity bill levels.[49] Accordingly, the Commission concludes that take-or-pay considerations do not justify inclusion of gas costs in minimum commodity bills. Instead, take-or-pay matters will

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[48] The Staff should also consider whether take-or-pay carrying costs might be more appropriately handled as a sub-account of the pipeline's rate base that earns a lower level of return than the rest of the rate base. In addition, Staff should consider whether the pipeline's operational situation should bear on the handling of take-or-pay prepayments, *i.e.*, should upstream pipelines (those that buy most of their supply directly from producers) be treated differently from downstream pipelines (those that purchase most of their supply from other pipelines). Staff should also study whether carrying costs should be based on interest costs less taxes.

[49] This finding is augmented by the Commission's general understanding that many pipelines are not making take-or-pay payments in any case. *See, e.g.*, Tennessee Gas Pipeline Co., Docket No. RP83-109, "Complaint, Request for Evidentiary Hearing and for Expedited Consideration, and Petition for Declaratory Orders."

continue to be handled in individual pipeline rate cases in accord with the foregoing discussion.[50]

VII. *Legal Issues*

A. *Rulemaking* v. *Adjudication*

A number of commenters oppose the rule on a legal basis. They assert that the Commission does not have the requisite legal authority to promulgate a rule that changes existing tariffs. They state that section 5(a) of the Natural Gas Act permits such actions only "after a hearing." This statutory language, they argue, bars the Commission from altering existing minimum bills without an adjudicatory proceeding, pipeline by pipeline.

The Commission disagrees. The public interest mandates generic action on this subject, and legal precedent clearly establishes the Commission's authority to so act under section 5. During the past eighteen months the problems associated with minimum bills have become particularly acute. Numerous complaints have been filed[51] and minimum bills have been the subject of controversy in a great many pipeline rate cases before this Commission. Some of these proceedings have gone to hearing and await decision; some have recently been set for hearing; some are in the settlement discussion stage; some have been settled. Some settlements are about to expire or will expire in the near future.

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[50] Some pipelines are currently operating under settlements that link minimum bill relief and take-or-pay recovery. This rule does not affect any such take-or-pay treatment for the terms of those settlements.

[51] Among these are Columbia Gas v. Kentucy-West Virginia, RP83-12; Columbia Gas v. Panhandle Eastern, RP83-5; Columbia Gas v. Tennessee Gas, RP83-3; Tennessee Gas v. Columbia Gas, RP83-19; Inland Gas v. Tennessee Gas, RP83-10; Central Illinois v. Panhandle Eastern, RP82-105; State of Michigan v. Trunkline Gas, RP81-103; Northwest Central v. Arkansas-Louisiana Gas, RP83-85; Michigan Consolidated v. Panhandle Eastern, RP83-84. There are a number of other dockets.

While the Commission could continue to consider the issue on a case-by-case basis, it had determined that the problem is so pervasive and so significant as to make action on a generic basis far more appropriate, not to mention expedient.

Legal precedent clearly permits such an approach. The Supreme Court has expressly recognized that written comments may satisfy the statutory requirements of a hearing. *United States* v. *Florida East Coast Ry. Co.*, 410 U.S. 224 (1973). Further, circuit courts have confirmed that this Commission may employ a rulemaking as an informal hearing under the Natural Gas Act. *Phillips Petroleum Co.* v. *FPC*, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974); *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834 (5th Cir. 1978), *cert. dismissed*, 439 U.S. 801.

Indeed, section 5 has never been construed to require a formal evidentiary hearing in all cases, not even when some parties disagree with a proposed settlement. *Placid Oil Co.* v. *F.P.C.*, 483 F.2d 880 (5th Cir. 1973), *aff'd*, 417 U.S. 283; *Amoco Production Co.* v. *F.P.C.*, 465 F.2d 1350 (10th Cir. 1972). *See also Pennsylvania Gas & Water Co.* v. *F.P.C.*, 463 F.2d 1242 (D.C. Cir. 1972); *Mich. Consolidated Gas Co.* v. *F.P.C.*, 283 F.2d 204 (D.C. Cir. 1960). Nor does the Commission violate the Natural Gas Act by not conducting an evidentiary hearing when it has solicited data and comments, provided an opportunity for reply comments, issued its opinion and entertained rehearing petitions. *Tenneco Oil Co.* v. *F.E.R.C.*, 571 F.2d at 841. Thus, the Commission has substantial flexibility under section 5 to act without evidentiary hearing, particularly in ruling on a matter that involves policy as broad as that of the instant rule.

Finally, any question as to the Commission's ability to alter rates by rulemaking was certainly laid to rest by the enactment in 1977 of the Department of Energy Organization Act, 42

U.S.C. § 7102-7332. Section 403(c) of that Act specifically provides that the Commission may act by rulemaking on rate matters:

> Any function . . . which relates to the establishment of rates and charges under the . . . Natural Gas Act, may be conducted by rulemaking procedures.

With respect to the conduct of any such rulemaking procedures, a rulemaking is considered procedurally adequate as long as it gives the parties fair notice of what the Commission proposes to do and an opportunity to make written submissions with or without opportunity for oral presentation. 5 U.S.C. § 553; *American Public Gas Ass'n* v. *F.P.C.*, 498 F.2d 718, 722-723 (D.C. Cir. 1974). The Commission's Notice also meets this standard and its further provision for reply comments enabled parties to respond to the initial comments submitted.

Discretion in the selection of procedures is especially important to the Commission's functions under the Natural Gas Act, which demand flexibility. As the Supreme Court has stated:

> The breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties.[52]

The Commission believes that the administrative procedure chosen to deal with the minimum commodity bill issue is entirely appropriate to the generic nature of the problem.[53]

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[52] Permian Basin Area Rate Cases, 390 U.S. 747, 790 (1968).

[53] At the same time it issues this rule, the Commission is also issuing an order in Colorado Interstate Gas Co., Docket No. RP82-54-000. That order is the Commission's decision on a fully adjudicated minimum bill proceeding conducted before an Administrative Law Judge. In that case, the Judge found that recovery of variable costs in CIG's minimum bill to Natural Gas Pipeline Co. was unjust and unreasonable and ordered its elimination. The Commission's decision affirms the Judge's finding. While the Judge considered the particular facts presented by CIG, Natural, Staff and others, the essential issue was the same as the essential issue considered in the

B. *Effect on Existing Settlements*

Some commenters also argued that whatever rule is promulgated should not be applicable to existing settlement agreements. They stated that the minimum commodity bill provisions of a particular settlement may have been a trade-off for some other concession, and that it would therefore be unfair to change the minimum commodity bill alone. Others believe the Commission is legally bound by the terms of a settlement once it has been approved.

The Commission agrees with these commenters that approved settlements are of a binding nature. *Texas Gas Transmission Corp.* v. *F.P.C.*, 441 F.2d 1392, 1395 (6th Cir. 1971). This binding nature, however, is not so inviolate that a settlement must remain in force when the Commission later finds, pursuant to section 5 of the Natural Gas Act, that the settlement reflects a provision found to be unjust and unreasonable. The Commission recently spoke on this specific point in *Mid-Louisiana Gas Co.*, 21 FERC ¶ 61,072 at p. 61,251:

> In addition to binding the parties to a litigated proceeding, a settlement, once approved, also binds the Commission. In accepting a settlement, the Commission makes a finding that the settlement is compatible with the public interest and it is therefore precluded from reversing this finding *absent an order after an investigation under Section 5 of the NGA.* (Emphasis added).

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instant rule. In another adjudicated minimum bill case, United Gas Pipe Line Co., 23 FERC ¶ 63,125 (1983), United's minimum bill to its pipeline customers was found unjust and unreasonable by the presiding Judge. (The Commission did not reach the merits of that case because it was settled following the Initial Decision (25 FERC ¶ 61,088 (1983)). The Commission believes that if it were to proceed case-by-case to consider every minimum bill in every existing pipeline tariff, the issues would essentially boil down to the same ones considered in this rule, and the results could be expected to be the same as the result reached in this rule.

The record and finding in the instant rulemaking docket constitute a section 5 proceeding that comports with requirements of the Natural Gas Act, the Department of Energy Organization Act, the Administrative Procedure Act, and judicial precedent. As such, the Commission's section 5 findings in this docket apply to all tariffs currently on file or filed in the future. Whether these tariffs were the product of an uncontested filing, an adjudicated case, or a settlement agreement is irrelevant for purposes of this rule.

C. *Effect of Rule on Current Cases*

As noted above, there are a number of ongoing cases at the Commission which involve minimum commodity bills. In some of these cases the minimum commodity bill is the only issue; in others it is joined by additional matters.

All of these cases will obviously be affected by the instant rule, which will remove purchased gas costs from minimum commodity bills, and thus alter the participants' starting point. This does not mean, however, that any of these cases will necessarily be terminated. Major issues in many cases, for example, are the types of *fixed* costs in the pipeline's minimum commodity bill and the volumes to which the minimum commodity bill applies. These are matters that the Commission does not address on a generic basis in the instant rule. *See* discussion *infra*. Accordingly, the Commission expects ongoing cases to continue and leaves to the respective Administrative Law Judges the ordinary responsibility for managing each case. The participants are, of course, encouraged to enter into settlements whenever possible.

VII. *Other Issues*

A. *The Need for Pipeline-by-Pipeline Proceedings*

Some commenters state that their particular situations differ from those of the industry as a whole.[54] For this reason, if a rule

[54] *See*, for example, comments of MIGC, Inc. (casinghead gas wells).

is promulgated, they seek separate proceedings on whether their own minimum commodity bills should be altered.

The Commission notes that these commenters do not necessarily reject the notion that minimum bills are a serious problem in the natural gas industry. They would merely have the rule not apply to them and have the Commission deal with their particular situations separately.

In response to these commenters, the Commission notes that once a generic regulation takes effect, any person is free to file a petition for waiver of that regulation under 18 C.F.R. § 385.207. The procedures for filing such a petition are set forth at 18 C.F.R. § 385.203. The Commission cautions, however, that it will not be generally inclined to grant exceptions to the rule in light of the strong public interest considerations that it embodies.

B. *Cost-of-Service Tariffs*

A number of commenters asked the Commission to make it clear that the instant rule is limited to stated-rate tariffs and does not apply to so-called "cost-of-service" tariffs.

Under a cost-of-service tariff, the pipeline is permitted recovery of its actually incurred costs, essentially at the same time the costs are incurred. Tariffs of this nature have occasionally been permitted by the Commission in order to make reasonably-priced financing more feasible for projects of an unusual nature.[55] Cost-of-service tariffs have also been permitted where the pipeline provides only one type of service (*e.g.*, transportation) and where only one customer (such as an affiliated company) or a limited number of customers are provided service.

Cost-of-service tariffs do not generally have a commodity charge and a demand charge. Rather, customers are required to

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[55] Some cost-of-service pipelines have been certificated on a "project financing" basis. These pipelines are discussed separately *infra*.

pay their allocated share, according to a prescribed formula, of the fixed and variable costs the pipeline incurs every month. Accordingly, the commenters allege, there is no possiblity of collection of variable costs not incurred. For this reason they believe cost-of-service tariffs should not fall within the scope of the instant rule.

The Commission disagrees. There is nothing in this record to indicate that cost-of-service tariffs do not necessarily contain the same anti-competitive restrictions as stated-rate tariffs. Rather, the record demonstrates to the contrary.[56] The Commission has found *supra* that the anti-competitive aspects of minimum commodity charges for variable costs make such charges unjust and unreasonable. Accordingly, it would be inconsistent with that finding and with the purposes of this rule to carve out an exception for cost-of-service tariffs.

The rule as promulgated herein makes inoperative "any pipeline . . . tariff governing the sale of natural gas . . . to the extent it provides for recovery of purchased gas costs for gas not taken by the buyer." This means that to the extent the customer of a cost-of-service pipeline purchases below the minimum level required in the tariff,[57] it may not be charged for the gas it does not take.

Accordingly, cost-of-service pipelines will be placed in the same position as fixed-rate pipelines with respect to recovery of variable costs. They will be able to charge their customers for only the gas those customers actually wish to purchase. If cost-of-service pipelines incur take-or-pay obligations with their producers or supply sources as a result of this rule, they may flow through the carrying charges on those obligations in the

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[56] *See* comments of El Paso Natural Gas Company.

[57] The minimum level provision in a cost-of-service tariff may be labeled a "take-or-pay" or "minimum take" requirement rather than a "minimum commodity bill." The label is irrevelant for purposes of this rule. *See* n.4, *supra* at 2.

manner currently provided in their tariffs[58] or they may seek changes in their rate treatment by making a section 4 filing with the Commission.

The Commission stresses that this result does not alter any take-or-pay obligations a cost-of-service pipeline may have with its supply sources. Further, it leaves unchanged the recovery of fixed costs such as debt services via a cost-of-service tariff.

C. *Transportation Tariffs*

The Commission's Notice invited comments as to whether minimum bills in transportation tariffs as well as sales tariffs should be precluded from recovering variable costs. A number of commenters responded to this invitation, and the Commission is pleased to have these comments. For the present time, the Commission has decided not to address this issue. The matter may be taken up at a later time. Accordingly, the terms of the instant rule do not apply to transportation tariffs.[59]

D. *Total Elimination of Minimum Commodity Bills*

The Notice in this docket stated that the Commission would also explore the extent to which pipelines should be assured recovery of their fixed costs through minimum commodity bill provisions. In response to this statement, a significant number of

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[58] To this extent, cost-of-service pipelines do maintain an advantage over stated-rate pipelines in that the former receive automatic flow-through of take-or-pay carrying charges, while the latter must make a section 4 filing to reflect any changes in take-or-pay costs. This advantage, however, is necessitated by the nature of cost-of-service tariffs, which are intended to provide automatic recovery of fixed costs such as carrying charges on debt.

[59] Consistent with this determination, the Commission notes that, by its terms, this rule does not apply to transportation rates for gas transported through any portion of the Alaska Natural Gas Transportation System (ANGTS). Several commenters expressed concern about this subject. The Commission emphasizes to these commenters that the instant rule in no way applies to ANGTS transportation tariffs.

commenters urged the Commission to eliminate not only variable costs but also fixed costs from minimum commodity bills. In other words, these commenters suggested that minimum commodity bills be totally eliminated.

The Commission has considered the arguments made on both sides of this issue and does not rule out the possibility of such a rule in the future. For the present, however, the Commission believes it would be best to take only the step proposed in the Notice. Accordingly, the Commission intends to assess the impact of removal of variable costs from minimum commodity bills before it takes any further generic steps on this subject. Parties and Staff are, of course, free to make such arguments in individual cases.

E. *Project-Financed Pipelines*

The Notice requested comment on whether the proposed rule should be extended to include pipelines certificated under "project financing." (Notice at p. 32,673) "Project financing" is a financing technique under which the lender relies on an assured stream of income from the project as collateral for the loan.[60] Most project-financed pipelines operate under a cost-of-service tariff.

Some commenters expressed the opinion that the rule should not apply to project-financed pipelines, because changes in tariffs associated with these types of pipelines could have a negative impact on lenders' perceptions of regulatory risk in the pipeline industry.

For the reasons discussed *supra* regarding cost-of-service pipelines, the Commission finds that project-financed pipelines should not be exempted from the instant rule. In making this

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[60] The assured revenue is generated by the provisions of the tariff. The lender's recourse for demanding repayment of the loan is limited to the discrete project and the lender has no recourse to other assets of the project owners.

finding the Commission notes its understanding that under existing tariffs all debt service costs, operating and maintenance costs, and taxes other than income taxes will be collected by project-financed pipelines regardless of their throughput of natural gas. Accordingly, the Commission does not believe that the financial basis upon which these pipelines were certificated will be altered. Under these circumstances, it is in the public interest to place project-financed pipelines on the same footing as all other pipelines with respect to collection of variable costs via minimum bill requirements.

F. *Make-Up Provisions*

The Commission also invited comment on the role of make-up provisions in minimum commodity bills. Notice at p. 32,672. Make-up provisions would allow customers to receive later delivery of gas paid for but not taken.

Nearly all of those commenting on this issue felt that while make-up provisions in minimum commodity bills would be preferable to no relief at all, a rule simply allowing for make-up would not resolve either of the concerns identified in the Notice. Customers might still have to pay for gas not taken and freedom to seek cheaper supplies would continue to be restricted. As one commenter put it, a make-up proviso would "merely lessen somewhat the gross inequity of the minimum commodity bill."

Many commenters reflected the concern expressed in the Notice that make-up relief would only be useful if reduced takes were temporary rather than permanent in nature. They stated that current depressed market conditions may continue for some time, leaving make-up provisos of little benefit. One commenter further pointed out that capacity constraints could limit make-up utility. Most customers, it was noted, take up to their contract entitlement in winter. Thus, the pipeline may be at full capacity during the only period that a customer might be able to utilize make-up gas in excess of its regular entitlement. Again, this would leave the make-up clause of little value.

The Commission considered all comments on this issue in reaching its conclusions in this docket. In view of the rule adopted herein, it is unnecessary for the Commission to take any action with respect to make-up clauses.

VIII. *Regulatory Flexibility Act Certification*

The Notice of Proposed Rulemaking certified that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities. The Commission affirms this finding with respect to the final rule adopted today.

As noted previously, the rule affects the contents of tariffs filed by pipelines who are regulated as natural gas companies under the Natural Gas Act. The tariff prohibition established by the rule denies these pipelines recovery of purchased gas costs (and other variable costs) for gas not taken by the buyer. The rule also requires that certain tariff sheets be refiled to state purchased gas costs separately from other costs. This refiling requirement should not result in any significant expenses for affected pipelines, particularly since this information is currently known to the pipelines. The separate statement of these costs will, however, enable small entities, such as some local distribution companies, to inspect the tariff sheets in the pipeline company's office and to avoid the unncessarily burdensome expense of locating purchased gas cost information among all the information filed by the pipeline with this Commission.

Accordingly, any economic impact resulting from this rule will not be "significant" as that term is used in the Regulatory Flexibility Act, (RFA).[61] Further, these regulated pipelines are virtually all large-size companies that do not fall within the RFA's definition of small entity.[62]

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[61] 5 U.S.C. § 601-612 (Supp. V 1980).

[62] 5 U.S.C. § 601(3)-(6), citing section 3 of the Small Business Act, 15 U.S.C. § 632 (1982), which defines "small business concern" as a business which is independently owned and operated and which is not dominant in its field of operation. *See* SBA's revised Small

One commenter suggests that the proposed rule requires a formal RFA study because it would have an adverse effect on small producers. The rule, it is argued, would lead to reductions in takes of gas from producers, creating lease maintenance, drainage, and other operating problems.

Leaving aside the merits of this theory, the Commission believes that this commenter misunderstands the intent of the RFA. Both the language of the statute and the legislative history make clear that Congress enacted the RFA to ease any disproportionate burden on small businesses that are *subject to* federal regulations.

Small producers are not subject to this rule and the Commission is therefore not required to perform a formal RFA study of the rule's impact. Rather, as noted in another recent rulemaking proceeding,[63] this Commission, like other agencies,[64] is required by the RFA to analyze only the effect of rules on regulated small entities *to which the rules apply*.

This is clearly evident in the Congressional Findings and Purposes, Section 2, Pub. L. No. 96-354, codified at 5 U.S.C. § 601, note. The Congress found:

* * *

Business Size Standards, 49 Fed. Reg. 5024 (Feb. 9, 1984) (to be codified at 13 C.F.R. Part 121).

[63] Final Rule, Construction Work in Progress for Public Utilities; Inclusion of Costs in Rate Base, 48 Fed. Reg. 24,323 (June 1, 1983) (Docket No. RM81-38-000, Order No. 298), *rehearing granted in part and denied in part*, 48 Fed. Reg. 46,012 (Oct. 11, 1983).

[64] *See e.g.* 47 Fed. Reg. 5215 (Feb. 4, 1982) (final rule of Securities and Exchange Commission).

> (2) laws and *regulations* designed for application to large scale entities *have been applied uniformly to small businesses, small organizations, and small governmental jurisdictions* even though the problems that gave rise to government action may not have been caused by those smaller entities;
>
> (3) *uniform Federal regulatory and reporting requirements have in numerous instances imposed* unnecessary and disproportionately burdensome demands including legal, accounting and consulting costs upon small businesses . . . with limited resources . . . [Emphasis added.]

Thus, Congress found that uniform regulation applied to small business entities caused unnecessary burdens. Congress therefore declared:

> (b) It is the purpose of this Act . . . to establish as a principle of regulatory issuance that agencies shall endeavor, consistant with the objectives of the rule and of applicable statutes, to fit regulatory and informational requirements to the scale of the businesses, organizations and governmental jurisdictions *subject to regulation* . . . [Emphasis added.]

Congress could not have been plainer about the reach of the statute: when an agency issues a rule that applies to small entities, the agency must consider, and try to mitigate, the burden on those small entities of compliance with the rule. Congress was not asking agencies to study any potential economic effects on small entities *not* subject to the rule.

The legislative history echoes this focus on burdensome reporting and compliance requirements. Senate Report No. 96-878, 86th Cong., 2d Sess. 1 (1980), reprinted in 1980 U.S. Code Cong. & Ad. News 2788, states that regulatory flexibility is needed because agencies tend to promulgate regulations of uniform applicability that "implicitly assume that all those subject to them are basically alike." *Id.* at 3.

> The Committee has also found that these regulations of general and uniform applicability tend to place a disproportionate burden upon small businesses, small organizations and small governmental bodies.

As evidence for this Congressional finding, the Report quotes testimony that

> [l]arge firms generally already have extensive 'in house' data compilation and reporting systems and specialized staff accountants, lawyers, whose primary function is regulatory compliance. Small firms, by comparison, must either hire additional personnel or purchase expensive consultive services in order to acquire the necessary regulatory expertise. *Id.* at 4.

These aspects of Senate Report No. 96-298 were repeated during the floor action on, and amendments of, the RFA bill before enactment. *See* "Description of Major Issues and Section-by-Section Analysis of Substitute for S. 299," 126 Cong. Rec. § 10,930, 10,934-43 (Aug. 6, 1980); "Discussion of Issues," 126 Cong. Rec. H8, 456, 8, 468-70 (Sept. 8, 1980). For example, the Senate Section-by-Section Analysis explains that "[t]he bill, therefore, is designed to encourage agencies to tailor their rules to the size and nature of those to be regulated . . " 126 Cong. Rec. at § 10,935. Similarly, the House Discussion of Issues points out that "agencies are directed to assess such options as 'tiering' (that is, setting different and less burdensome requirements on smaller entities), exemptions from all or part of rules, the structuring of different timetables for compliance . . ." *Id.* at H8468. These examples clearly are grounded on the premise that the smaller entities are subject to the rules.

The Commission therefore concludes that there is no provision of the RFA that requires an analysis of the impact of minimum commodity bill regulations on small producers that are not subject to any part of this rule. Accordingly, the Commission affirms its earlier conclusion that, pursuant to section 605(b) of

the RFA, this rule will not have a significant economic impact on a substantial number of small entities.

IX. *Effective Dates and Paperwork Reduction Act Statement*

The Commission originally proposed to make any final rule adopted as a result of this proceeding effective as of November 1, 1983. In view of the legal and practical objections to this date raised by certain commenters, the Commission will make the rule prospective only. Further, since the Commission recognizes that the rule will have an impact on pipeline planning and policy, it will become effective, except for paragraph (a)(3) of § 154.111, on [insert date 60 days from the date of publication in the *Federal Register*].

The information collection provision in paragraph (a)(3) of § 154.111, which requires that revised pipeline rate schedules and tariffs be filed where necessary to separately state purchased gas costs, will be submitted to the Office of Management and Budget (OMB) for approval and assignment of a control number under the Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520 (Supp. V 1981), and OMB's regulations, 5 C.F.R. Part 1320 (1983). Accordingly, the filing requirement of paragraph (a)(3) of § 154.111 will not become effective until [insert date 75 days from publication in the *Federal Register*] and the deadline for actually filing will be [insert date 105 days from publication in the *Federal Register*]. If OMB's approval and control number have not been received by [insert date 75 days from publication in the *Federal Register*], the Commission will issue a notice temporarily suspending the effective date.

Any Part 381 filing fees that would otherwise be associated with paragraph (a)(3) of § 154.111 are hereby waived to the extent the filing relates exclusively to the requirements of that paragraph.

Interested persons may obtain information on the information collection provisions of this rule by contacting the Federal

Energy Regulatory Commission, 825 North Capitol Street, N.E., Washington, D.C. 20426 (Attention: Carol M. Lane, (212) 357-8383). Comments on the information collection provisions may be sent to the Office of Management and Budget, Office of Information and Regulatory Affairs, Washington, D.C. 20503 (Attention: Desk Officer for the Federal Energy Regulatory Commission).

List of Subjects

18 C.F.R. Part 154

Natural gas.

In consideration of the foregoing, the Commission is amending Part 154, Title 18, *Code of Federal Regulations,* as set forth below.

By the Commission. Commissioner Sousa concurred with a separate statement to be issued later.

(S E A L)

Kenneth F. Plumb,
Secretary.

1. The authority for Part 154 continues to read as follows:

Authority: Natural Gas Act, 15 U.S.C. §§ 717-717z (1982); Department of Energy Organization Act, 42 U.S.C. §§ 7102-7352 (1982); Executive Order 12009, 3 C.F.R. 142 (1978); Independent Offices Appropriations Act, 31 U.S.C. § 483a (1970).

2. Part 154 is amended in the table of contents by adding in appropriate numerical order a new § 154.111 to read as follows:

Part 154 — Rate Schedules and Tariffs

* * *

154.111 *Limitations on provisions in rate schedules and tariffs.*

* * * * *

3. Part 154 is amended further by adding a new § 154.111 to read as follows:

§ 154.111 *Limitations on provisions in rate schedules and tariffs.*

(a) *Limitations.*

(1) Effective [insert date 60 days from publication in the *Federal Register*], any pipeline rate schedule or tariff governing the sale of natural gas shall be inoperative and of no effect at law to the extent it provides for recovery of purchased gas costs for gas not taken by the buyer.

(2) No rate schedule or tariff governing the sale of natural gas and filed on or after [insert date 60 days from publication in the *Federal Register*] may provide for recovery of variable costs associated with gas not taken by the buyer.

(3) (i) Any pipeline rate schedule or tariff governing the sale of natural gas that either (A) was in effect on [insert date 60 days from Publication in the *Federal Register*] or (B) was filed after that date but prior to [insert date 105 days from

publication in the *Federal Register*] and does not state purchased gas costs separately from other charges shall be restated to state such costs separately and filed on or prior to [insert date 105 days from publication in the *Federal Register*], and

(ii) any pipeline rate schedule or tariff governing the sale of natural gas and filed on or after [insert date 105 days from publication in the *Federal Register*] shall state purchased gas costs separately from other charges.

(b) *Definition.* For purposes of this section, the term "purchased gas costs" means the cost of purchased gas, compressor fuel gas, and line loss or shrinkage gas.

Appendix

Comments Filed By:

Maryland Public Service Commission
The Berkshire Gas Company
The American Gas Association
Northern States Power Company
Baltimore Gas and Electric Company
North Penn Gas Company
The State Corporation Commission of Kansas
Equitable Gas Company
San Diego Gas and Electric Company
Public Service Electric and Gas Company
Penn Fuel Gas, Inc.
New England Customer Group
Ozark Gas Transmission System
Natural Gas Pipeline Company of America
The East Ohio Gas Company
The Peoples Gas Light and Coke Company
American Paper Institute, Inc.
Phillips Petroleum Company and Phillips Oil Company
Southern California Edison Company
Trailblazer System Companies
Columbia Gas Transmission Corporation
El Paso Natural Gas Company
The Brooklyn Union Gas Company
Chattanooga Gas Company
Foothills Pipe Lines (Yukon) Ltd.
Pan-Alberta Gas Ltd.
Washington Gas Light Company, Frederick Gas Company, Inc. and Shenandoah Gas Co.
United States Steel Corporation
United Gas Pipe Line Company
Great Lakes Gas Transmission Company
Public Service Commission of the State of New York
The National Association of Regulatory Utility Commissioners
Arkansas Louisiana Gas Company
North Carolina Natural Gas Corporation & Public Service Company of North Carolina
Carolina Pipe Line Company and South Carolina Electric and Gas Company

Mississippi River Transmission Corporation
Laclede Gas Company
Texas Eastern Transmission Corporation and Transwestern Pipeline Company
New Jersey Natural Gas Company
Northern Indiana Public Service Company
The Staff of the Pennsylvania Public Utility Commission
Public Utilities Commission of Ohio
Pacific Gas and Electric Company
Mountain Fuel Supply Company
Consumers Power Company
T. W. Phillips Gas and Oil Company
Minnegasco, Inc.
The People of the State of California and the Public Utilities Commission of the State of California
Illinois Commerce Commission
New York State Electric and Gas Corporation
Colorado Interstate Gas Company
Governor George Deukmejian and Attorney General John K. Van De Kamp
Michigan Wisconsin Pipe Line Company
Northern Border Pipeline Company
The Process Gas Consumers Group, The American Iron and Steel Institute, The Association of Businesses Advocating Tariff Equity, The Aluminum Association, and the Georgia Industrial Gas Group
Kentucky West Virginia Gas Company
Northern Illinois Gas Company
Mustang Fuel Corporation
The Gas Service Company
Consolidated Edison Company of New York, Inc.
National Fuel Gas Supply Corporation
UGI Corporation
High Island Offshore System
Tennessee Gas Pipeline Company, A Division of Tenneco, Inc.
Stauffer Chemical Company
Consolidated Gas Supply Corporation
The Tennessee Gas Pipeline Company, A Division of Tenneco, Inc. and Midwestern Gas Transmission Company
Pacific Gas Transmission Company
Columbia Gas Distribution Companies

Pacific Interstate Companies
City Gas Company, Madison Gas and Electric Company, Wisconsin Fuel and Light Company, Wisconsin Gas Company, Wisconsin Natural Gas Company, Wisconsin Power and Light Company, and Wisconsin Public Service Corporation
The Philadephia Electric Company and The Philadelphia Gas Works
Southern California Gas Company and Pacific Lighting Gas Supply Company
Northwest Alaskan Pipeline Company, as Operator, on behalf of Alaskan Northwest Natural Gas Transportation
Northwest Energy Company on behalf of Northwest Pipeline Corporation and Northwest Central Pipeline Corporation
The Public Service Commission of Wisconsin
U-T Offshore System
Michigan Consolidated Gas Company
Algonquin Gas Transmission Company
Southwest Gas Corporation, Arizona Public Service Company, Southern Union Gas Company and Gas Company of New Mexico
Southern Union Gas Company and Gas Company of New Mexico
The State of Michigan and The Michigan Public Service Commission
Texas Gas Transmission Corporation
Panhandle Eastern Pipe Line Company and Trunkline Gas Company
Northern Natural Gas Company, Division of InterNorth, Inc.
Minnesota Department of Public Service
Tennessee Gas Pipeline Company
Wyoming Public Service Commission
Kentucky Public Service Commission
Federal Trade Commission
State of New Jersey Dept. of Energy
MIGC Inc.
Nelson Yeardley, Greenville, Pennsylvania
Transwestern Pipeline Company

Reply Comments Filed By:

American Gas Association
Michigan Consolidated Gas Company

Northern Indiana Public Service Company
The Peoples Gas Light and Coke Company
Pacific Gas Transmission Company and
Pacific Gas & Electric Company
Natural Gas Pipeline Company of America
Arkansas Louisiana Gas Company
Transwestern Pipeline Company
UGI Corporation
Consolidated Gas Supply Corporation
The Philadelphia Electric Company and The Philadelphia
Gas Works
The Process Gas Consumers Group, The American Iron &
Steel Institute, The Association of Business Advocating
Tariff Equity, The Aluminum Association, and The Georgia
Industrial Gas Group
ANR Pipeline Company
United Gas Pipe Line Company
El Paso Natural Gas Company
Tennessee Gas Pipeline Company, a Division of Tenneco, Inc.,
and Midwestern Gas Transmission Company
Northern Illinois Gas Company
Great Lakes Gas Transmission Company
Texas Gas Transmission Corporation
Southern California Gas Company and Pacific Lighting Gas
Supply Company
Consumers Power Company
Southwest Gas Corporation, Arizona Public Service Company,
Southern Union Gas Company and Gas Company of
New Mexico
MIGC, Inc.
Mississippi River Transmission Corporation
Consolidated Edison Company of New York, Inc.
The Brooklyn Union Gas Company
Transcontinental Gas Pipe Line Corporation
Panhandle Eastern Pipe Line Company and
Trunkline Gas Company
Texas Eastern Transmission Corporation
Northwest Energy

APPENDIX E

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, A. G. Sousa, and Oliver G. Richard III.

Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions } Docket No. RM83-71-001 through 030

ORDER NO. 380-A
ORDER DENYING REHEARING AND GRANTING IN PART APPLICATIONS FOR STAY

(Issued July 30, 1984)

I. Introduction

The Federal Energy Regulatory Commission (Commission) recently issued Order No. 380,[1] a Final Rule requiring elimination from natural gas pipeline tariffs of any minimum commodity bill provisions that operate to recover variable costs. The instant order grants a stay of one aspect of the Rule, makes certain clarifications, and grants one waiver. In all other respects it denies rehearing and stay and affirms Order No. 380.

II. Procedural Background

Petitions for rehearing of Order No. 380 were due on or before June 25, 1984. Twenty-five entities filed timely petitions[2] seeking rehearing, stay, and/or clarification of the order.[3] The

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[1] 27 FERC ¶ 61,318 (May 25, 1984), 49 Fed. Reg. 22778 (June 1, 1984).

[2] A list of all such petitions is attached to this order as Appendix A.

[3] An Order Granting Rehearing for Purposes of Further Consideration was issued on July 23, 1984, to prevent denial by operation of

issues raised in these timely petitions are individually discussed *infra*. One entity, the Independent Petroleum Association of Canada (IPAC), filed for rehearing one day after the deadline. While IPAC's petition is untimely in terms of rehearing, the Commission will treat it as a motion for reconsideration and will consider the issues it raises, which issues were, in general, raised by several timely petitioners.

Also filed in this docket after the rehearing deadline was a letter with attachments from the National Energy Board (NEB), an agency of the Government of Canada. While the NEB did not seek any specific relief, it stated certain concerns with respect to Order No. 380. These concerns are also addressed *infra*.

A further procedural matter concerns the record in this docket. Several petitioners (*e.g.*, Wisconsin Distributors Group at 18-19) alleged that Order No. 380 is deficient because it does not provide specific citations to each record comment upon which the Commission relied in making various findings. In response to this concern, the Commission notes that its usual practice in rulemaking proceedings has been to discuss the comments in a general way ("one commenter explained that . . .") rather than in a specific manner ("Company A explained at page 5 that . . ."). The Commission believes that this practice is sufficient not only for rulemakings in general but also for rulemakings that make findings under section 5 of the Natural Gas Act, 15 U.S.C. ¶ 717d (1982).[4] The Commission agrees, however, that it would be helpful to interested persons if specific citations were made to at least some of the record comments that

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law. In that order the Commission noted its intent to act on the merits by July 31, 1984, the effective date of the Rule.

[4] Courts intend only "that the judgment is reasonably supported by substantial evidence which appears *somewhere in the record.*" Union Oil Co. of California v. FPC, 542 F.2d 1036, 1041 (9th Cir. 1976). (Emphasis added.)

were relied upon in making these section 5 findings. Accordingly, the instant rehearing order will provide such record citations in discussing the issues raised on rehearing. This should alleviate the concern of petitioners that there is no record support for those findings to which they object.

As a final background note, the Commission observes that Order No. 380 is a complex, sixty-page document that does not lend itself to brief summarization. Accordingly, this rehearing order proceeds on the assumption that the reader is already familiar with Order No. 380 and that the issues on rehearing may be discussed here with a minimum of explanatory background.

III. Minimum Physical Take

A number of commenters sought clarification or rehearing of Order No. 380 with respect to "minimum take" provisions in pipeline tariffs or in contracts with customers. As described in the petition of the California Public Utilities Commission (CPUC), a minimum take provision requires that the customer physically take delivery of the gas. Under such a provision, there is no option simply to pay for the gas and not take it. Rather, refusal to physically take in itself constitutes breach of the tariff or contract. (CPUC at 2.)

Under the Rule as promulgated, if a customer refused to take gas at the level required by a minimum take provision, the pipeline would be unable to charge the customer for the gas it did not take. This result occurs because § 154.111(a)(1) of the rule provides that:

> [A]ny pipeline rate schedule or tariff governing the sale of natural gas shall be inoperative and of no effect at law to the extent it provides for recovery of purchased gas costs for gas *not taken* by the buyer. [Emphasis added.]

CPUC and the Southern California Gas Co./Pacific Lighting Gas Supply Co. (SoCal/PLGS) ask the Commission to verify that this is precisely what was intended. Other petitioners (*e.g.*,

Pacific Gas Transmission Co./Pacific Gas & Electric Co. (PGT) at 29-30) ask the Commission to verify that this is *not* what was intended.

In response, the Commission notes that this is what was intended and was in fact specifically stated in Order No. 380 at page 53, footnote 57.[5] As the CPUC notes, such an interpretation is in keeping with the general intent of the rule. "A utility which must physically take gas from a pipeline which sells its gas at high or noncompetitive cost will be severely obstructed in its attempts to purchase the maximum amount of low cost gas available to it." (CPUC at 3.) It was not the Commission's intent to permit pipelines to evade the thrust of this rule simply because some of their tariff provisions are labelled "minimum take" provisions.

PGT and other petitioners, however, point out that this subject was not mentioned in the Notice of Proposed Rulemaking in this docket. They assert that while the subject was substantively addressed by a few commenters, those commenters urged a number of reasons[6] why they believe that minimum take provisions are substantively different from minimum commodity bills. Accordingly, the petitioners believe there is an insufficient record to support the Commission's findings that minimum take provisions in pipeline tariffs are unjust and unreasonable.

In order to accommodate the concerns of these petitioners, the Commission will reconsider this question and, by this order, will stay the effect of the Rule with respect to minimum take provisions in pipeline rate schedules or tariffs until November 1,

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[5] All citations herein to Order No. 380 are to the slip opinion issued May 25, 1984.

[6] Both economic and physical reasons are asserted, including the recovery of Canadian pipelines' fixed costs and the necessity of insuring that customers take sufficient quantities of gas to maintain marginal wells. These and other assertions will be discussed in the forthcoming Notice.

1984. The Commission will also issue a Supplemental Notice in this docket seeking comments on the minimum take issue. The comments thus received will be considered and this aspect of the Rule will be acted upon by November 1, 1984.[7]

IV. Section 7 Argument

A number of petitioners note that their own minimum bill provisions were part of the initial tariff and terms/conditions of service that were certificated by the Commission under section 7 of the Natural Gas Act (*e.g.*, Texas Gas Transmission Corporation at 20-22). Alteration of their minimum bill, they argue, would revoke a basic element of these certificates. Such action, it is asserted, is in excess of the Commission's statutory authority or, even if the Commission has such authority, such action cannot be exercised absent an adjudicated section 7 proceeding.

The Commission need not discuss here the question of whether or not it has the statutory authority to revoke or alter a certificate granted under section 7 of the Natural Gas Act. This question simply does not arise, because Order No. 380 does not revoke or alter any certificated authorization. This is the case even though the minimum bill provisions may have been part of the initial tariff approved at the time of certification. The minimum bill was only one among a number of tariff provisions pursuant to which the certificated service would be performed. The alteration of pipeline tariffs that is brought about by Order No. 380 is clearly within the Commission's sections 4, 5, and 16 authority under the Natural Gas Act for the following reasons.

Sections 4 and 7 of the Act establish the basic framework and authority under which the Commission regulates natural gas transportation and sale for resale in interstate commerce.

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[7] On July 9 and 10, 1984, Transwestern Pipeline Company and Pan-Alberta Gas, Ltd., respectively, filed Answers to the CPUC petition for clarification on the minimum take issue. Those Answers are incorporated into this record.

First, section 7(c) provides that natural gas companies must obtain authorization from the Commission, in the form of a certificate of public convenience and necessity, before constructing or operating any facilities to be used for activities within the Commission's jurisdiction. This authorization is given only if the Commission finds that the proposed service, sale, operation, or construction will be required by the present or future public convenience and necessity. Additionally, under section 7(b), the Commission's authorization must be obtained before any service or facilities subject to the Commission's jurisdiction are abandoned.

Second, section 4(a) establishes the general standard (which forms the purpose of the Act) that all rates and charges for service subject to the Commission's jurisdiction must be just and reasonable. Section 4(b) establishes an additional standard requiring that the transportation or sale for resale of natural gas by regulated companies may not result in the grant of any undue preference or advantage or subject any person to an undue prejudice or disadvantage. Any changes by a natural gas company in its rates, charges, classifications, or service may only take place after proper notice to the Commission, as specified in section 4(d).

In addition to this basic framework created by sections 7 and 4, Congress gave the Commission very significant authority in sections 16 and 5 of the Act. Section 16 reads in pertinent part:

> The Commission shall have power to . . . prescribe, issue, make, amend, and rescind such orders, rules or regulations as it may find necessary or appropriate to carry out the provisions of this act.

Section 5(a) provides, in pertinent part, that if the Commission:

> [s]hall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any *rule, regulation, practice or contract*

> *affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential,* the Commission shall determine the just and reasonable rate, charge, or classification, rule, regulation, practice, or contract to be thereafter obvserved and in force, and shall fix the same by order. [Emphasis supplied.]

These statutory pronouncements are mandatory as opposed to precatory. The broad language of section 16, when employed in conjunction with section 5, has permitted the Commission to alter and amend conditions to certificated service with full approval of the courts. Section 5(a) has been interpreted as giving the Commission authority to alter the terms and conditions of certificated service even though the affected parties, acting alone, could not have changed them. *F.P.C.* v. *Louisiana Power and Light Co.*, 406 U.S. 621, 646-647 (1972). In Opinion No. 754-A, Docket No. RP71-119, issued August 17, 1976, *aff'd on other grounds, Hercules, Inc.* v. *F.P.C.*, 559 F.2d 1208 (3rd Cir. 1977), the Federal Power Commission concluded, with court approval, that it could exercise its section 5 authority to promulgate new terms and conditions under which certificated service would be performed.

The combined effect of sections 5(a) and 16 is to *require* the Commission to change terms and conditions under which a pipeline renders a certificated service if those terms and conditions result in rates or charges which are subsequently found unjust and unreasonable. As the United States Court of Appeals for the District of Columbia Circuit stated in *American Smelting and Refining Company* v. *F.P.C.*, 494 F.2d 925, 940-941 (1974), *cert. denied,* 419 U.S. 882 (1974), once the Commission finds that an existing rate or charge is unjust or discriminatory,[8] it

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[8] The Commission's authority to find that a tariff (previously determined to be just and reasonable) no longer functions in a reasonable manner has been upheld by the U.S. Court of Appeals for the District of Columbia Circuit in Pacific Gas Transmission Co. v. F.P.C., 536 F.2d 393 (1976).

"must prescribe the remedy for that condition."[9] If the existing illegal rate or charge is the result of the operation of a provision that was set out in the initial tariff or terms and conditions of service when the certificate was issued, the remedy clearly will lie in the alteration of that provision.

Accordingly, rehearing on the basis of the section 7 argument is denied.

V. Section 5 Arguments and Requests For Clarification

In issuing Order No. 380, the Commission chose to act by rule under section 5 to remove unjust and unreasonable tariff provisions. The reasons for proceeding in this manner are set forth at pages 45-49 of the Order and need not be repeated here.

Some petitioners assert, however, that the Commission should instead have promulgated a statement of policy (*e.g.*, Kentucky West at 9) or should have adopted an alternative approach to the minimum commodity bill problem (ANR at 9-10). The Commission notes that these alternatives were less satisfactory remedies to the problem than adoption of the Rule. A statement of policy establishes guidelines but does not have the force and effect of law. The methodology proposed by ANR would not eliminate the anticompetitive effects of including variable costs in minimum commodity bills. Accordingly, the Commission chose to act in the manner prescribed in Order No. 380.

Other petitioners argue that, for one reason or another, the Commission acted improperly in applying a section 5 rule to the industry as a whole or to them as an individual company. Others asked for clarification. These matters are discussed below.

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[9] The D.C. Circuit has also taken this position in Pacific Gas Transmission Co. v. F.P.C., 536 F.2d at 396, where it stated that "[a]fter such a finding, the Commission had not only the power but a solemn duty to take immediate action."

Kentucky West Virginia Gas Company (Kentucky West):

Kentucky West asserts (at 2) that due to the "unique facts and circumstances" of its operations, it should be given an opportunity to demonstrate that it qualifies for a waiver of the Rule before the Rule takes effect. It bases this assertion on the following factual situation.

Kentucky West has a 66⅔ percent "take-or-pay"[10] requirement in the tariff under which it sells much of its gas. Kentucky West says it needs the assurance that volumes will actually be purchased at least at this level in order to enable it to plan its drilling and other production activities. Since approximately 90 percent of Kentucky West's system supply consists of its own or its affiliates' production, Kentucky West asserts (at 4) that its customers' obligations to purchase gas at a given level is "more in the nature of a 'take-or-pay' obligation to a producer" than a typical minimum commodity bill. As such, it is a "necessary financing mechanism to generate cash flow to cover costs incurred in the production and development of necessary gas reserves to meet system requirements" (at 7).

Assuming all the facts set forth by Kentucky West to be true, the Commission sees no reason to exempt this petitioner from the Rule. If anything, Kentucky West's petition demonstrates that it is in a better position than many other pipelines in terms of planning its gas purchase and sales activities. In the case of 90 percent of its system supply, it has the hands-on ability to make whatever price adjustments may be needed to meet its customers' marketing needs. Other pipelines whose purchased gas cost is high enough to cause them to lose sales must pursue renegotiations with their natural gas producers. Kentucky West, however, is *itself* the producer or the producer's affiliate in the case of 90 percent of its system supply. Kentucky West is thus in

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[10] The fact that a minimum commodity bill is labeled a "take-or-pay" requirement does not exempt it from this Rule. *See* Order No. 380 at 53, n.57.

a position to respond quickly to market demand and thereby keep its sales high enough to meet its cash flow needs. Further, this company can respond to market demand by reducing its production and drilling operations without incurring take-or-pay, another advantage it holds over many other pipelines.

Kentucky West also argues that its "unique rate structure" requires preservation of its existing minimum commodity bill. This structure consists of a straight commodity rate, with no demand charge to assure recovery of fixed costs.

Since Kentucky West has no demand charge, 100 percent of its fixed costs are recovered in its commodity charge. The instant Rule does not alter Kentucky West's minimum commodity bill with respect to fixed cost recovery. Before the Rule, Kentucky West was guaranteed recovery of the fixed costs associated with 66⅔ percent of its contract quantity. After the Rule, Kentucky West is guaranteed recovery of the fixed costs associated with 66⅔ percent of its contract quantities. Once again, the Commission stresses that the Rule only affects variable cost recovery via a minimum commodity bill. Thus, Kentucky West's "unique" rate structure provides no basis for a waiver of the Rule.[11]

Additionally, Kentucky West asserts that its minimum commodity bill requirement is the *quid pro quo* for its obligation to

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[11] Along the same lines, Kentucky West argues that the Commission's discussion of the traditional rate function of minimum commodity bills does not apply to Kentucky West (at 15-16). In Order No. 380 it was noted that, *inter alia,* minimum commodity bills have acted as "a kind of additional demand charge" to protect pipelines from the risk of underrecovery of fixed costs in the commodity component of the rate. Kentucky West finds this inapplicable since its rates include no demand charge. The fact that it has no demand charge, however, is irrelevant to the unrefuted fact that its minimum commodity bill acts exactly like a demand charge; it guarantees that Kentucky West will recover a particular level of fixed costs from its customers regardless of whether those customers buy any gas or not.

serve Columbia Gas, a large customer, ahead of all other customers. This argument is unpersuasive, particularly in light of the fact that Kentucky West serves two pipeline customers, Columbia and Equitable, under its PLS-1 rate schedule. *Both* of these customers are subject to a 66⅔ percent minimum commodity bill (at 3). Yet Equitable does not get priority of service; Columbia has this distinction. Accordingly, Columbia's priority status hardly presents a compelling justification for the existence of a minimum commodity bill in Kentucky West's PLS-1 rate schedule.

Kentucky West further asserts (at 16) that it does not fall under the general market situation described in Order No. 380, wherein the Commission notes that minimum commodity bills are a major obstacle to the transmittal of price signals. It notes that since it is the producer as well as the pipeline, such price signals can be directly transmitted. What Kentucky West overlooks is that it is the presence of the minimum commodity bill in itself that blocks market signals from being effective. Kentucky West may *know* that its prices are too high to effectively meet its customers' markets, but it has no *incentive* to lower those prices if its customers are forced to buy its gas anyway due to the minimum commodity bill. Effective market signaling is the objective the Commission seeks.

In sum, Kentucky West's rehearing petition has made a series of arguments that rely on certain factual ways in which its situation as a natural gas pipeline varies from the situations of other natural gas pipelines. Every rehearing petitioner has made or could make variations on this theme. The Commission does not disagree that each pipeline is somewhat different from the next. This was, needless to say, already well known to the Commission at the time it promulgated Order No. 380. The findings that the Commission made in that Order, however, were made with full knowledge of these various factual differences. As the above response to Kentucky West's factual arguments indicates, none

of these arguments dissuades the Commission from its finding that a pipeline tariff (such as Kentucky West's) permitting collection of variable costs not incurred is unjust and unreasonable. (*See, e.g.*, initial comments of Michigan Consolidated Gas Company; Chattanooga Gas Company; Penn Fuel Gas, Inc.; Kansas Corporation Commission; Southern Union Gas Company/Gas Company of New Mexico.)

Should Kentucky West's circumstances change in a way it believes is material to its minimum commodity bill, it is free to file for a waiver of the regulations at that time.

Great Lakes Gas Transmission Company (Great Lakes):

Great Lakes notes (at 4-7) that the Notice in this docket proposed to eliminate tariff provisions allowing collection of costs that are "not actually incurred." The resulting Rule, however, does not use this terminology. Instead, it prohibits tariff provisions allowing collection of purchased gas costs (and other associated variable costs) "for gas not taken by the buyer." Great Lakes states that this change in the Rule's language "prohibits some costs that are incurrred, specifically, take-or-pay costs."

Great Lakes apparently misunderstands the thrust of the Rule. Neither the Rule nor the preamble says that pipelines cannot recover prudently incurred take-or-pay costs. To the contrary, Order No. 380 specifically acknowledges (at 9-10) that some pipelines may incur additional take-or-pay costs without minimum commodity bill protection, and its discusses (at 43-45) various considerations to be taken into account when take-or-pay costs are allocated among a pipeline's customers. The Rule in no way "prohibits" recovery to take-or-pay costs.

Great Lakes, however, apparently believes that if the Rule were couched in terms of costs "not actually incurred," there would be a way it could then collect actually incurred take-or-pay payments via its minimum commodity bill. It was precisely

because of this misunderstanding that the Commission altered the proposed language when it finalized the Rule. As explained in detail at pages 40-45 of Order No. 380, the Commission has been unable to find a satisfactory *generic* procedure that assigns cost responsibility for actually incurred take-or-pay costs. Thus, it is unable to provide a specific methodology for recovery of these costs in conjunction with this Rule. On some pipeline systems it may be an easy task to assign such cost responsibility, such as where the pipeline has only one customer. On other systems it is far more difficult, such as where some customers are subject to minimum bills and some are not. This is why the Commission determined that the most reasonable way to assign cost responsibility for any prudently incurred take-or-pay payments that may result from the Rule was on a pipeline-by-pipeline basis. This conclusion has ample record support, *e.g.*, initial comments of Columbia Gas Transmission Corporation at 4-5; United States Steel at 3-8; Commonwealth of Kentucky Public Service Commission at 3-5; reply comments of Process Gas Consumers Group at 3-4. Accordingly, rehearing of the decision to deal with recovery of actually incurred take-or-pay costs outside the context of the Rule is denied.

Great Lakes next argues that there is no evidence for the Commission's view that when lower cost pipelines experience increased sales as a result of this Rule, this will lead to increased exploration and development by their producers (Order No. 380 at p. 36). In response, the Commission notes that this observation was made merely as the logical corollary of record comments (Southwest Gas Corporation, *et al.*, initial comments at 12) asserting that if a pipeline loses load as a result of the Rule, its producer-suppliers will reduce their gas exploration and development efforts accordingly.

Great Lakes further argues (at 6) that there is "no basis" for the Commission's implication at pages 41-42 of the Order that a pipeline would attempt to charge all customers for take-or-pay

costs it incurs in addition to collecting purchased gas costs that are not incurred.

Order No. 380 noted that payments of minimum commodity bills generally do not protect a pipeline's other customers from bearing take-or-pay carrying costs. The Commission stands by this statement. As it noted in the Order, none of the commenters opposing the proposed Rule showed how, under present circumstances, minimum commodity bill revenues would be used to offset gas prepayments, and thus prevent captive customers from bearing the associated carrying costs. The Commission's regulations that discuss Account No. 165, the rate base account that records take-or-pay prepayments, make no provision for reducing the balance in that account by any amounts collected via minimum commodity bills. (*See* FERC Statutes and Regulations, Vol. II, ¶ 20,165.) Indeed, the comments of Michigan Wisconsin (ANR), which opposed the proposed Rule, acknowledged the possibility under existing circumstances that a pipeline collecting minimum commodity bill revenues for gas not taken could also collect carrying costs on the gas prepayments.[12]

Great Lakes also makes an argument (at 12-13) that flows from the section 7 argument discussed *supra* at pages 6-10. It asserts that all of the terms and conditions of its certificate, including its minimum commodity bill reflecting its Canadian take-or-pay obligations,[13] were relied upon by lenders for long-term financing of Great Lakes' facilities. Thus, it argues, the Commission is "revoking" a "very significant term" of the sales contract it approved at the time of certification.

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[12] *See* initial comments of Michigan Wisconsin at 21-22. In Michigan Wisconsin's view, the possibility of this type of cost recovery is slight since most customers subject to a minimum commodity bill take their minimum volumes rather than pay the minimum commodity bill penalty. Also helpful on this subject are the initial comments of Gas Service Company at 7-8.

[13] A separate discussion of Canadian-related issues begins *infra* at 81.

As noted above, the Commission has already dealt with the section 7 aspects of this argument. With respect to the section 5 aspects, Great Lakes' argument might have merit if the Commission were altering the terms of Great Lakes' methodology for recovering its fixed costs. (A pipeline's fixed costs include costs of interest expense, depreciation, taxes, and return on its capital investments as well as certain operation and maintenance expenses.) Recovery of these fixed costs, which lenders may or may not have relied on, is not changed by the Rule. While take-or-pay costs *may* be higher for some pipelines as a result of this Rule, they do not become unrecoverable. As noted at pages 44-45 of Order No. 380, such costs, if prudently incurred, may be recovered from the pipeline's customers and should be so recovered in a manner best reflecting each customer's responsibility for incurrence of the take-or-pay obligation.

Like many other petitioners, Great Lakes asserts (at 21) that its circumstances are "unique" and that it should therefore be exempt from the Rule. It then goes on to describe circumstances that, while they may in some respects differ from other pipelines, present no reason why Great Lakes' minimum commodity bill tariff provisions do not present the concerns that led the Commission (Order No. 380 at 14-27) to find all such provisions unjust and unreasonable.

Finally, Great Lakes asks the Commission to clarify Order No. 380 in two respects. The first pertains to settlements.

The Commission noted in Order No. 380 (at 50) that the Rule affects all sales tariffs, regardless of whether the terms of those tariffs came about via an uncontested filing, an adjudication or a settlement. The Commission also noted, however, at page 45, footnote 50, that:

> Some pipelines are currently operating under settlements that link minimum bill relief and take-or-pay recovery. This rule does not affect any such take-or-pay treatment for the terms of those settlements.

Great Lakes asks whether this statement means that the Rule does not apply to certain settlements with its customers that reflect changes in its take-or-pay obligations to its Canadian supplier.

The Commission agrees that the above-quoted footnote needs clarification. The footnote had only one intent. That was to assure parties that where they had reached settlements providing minimum bill relief *consistent with this Rule (i.e.,* where the pipeline agreed not to recover variable costs via its minimum commodity bill for the duration of the settlement), any particular proviso for recovery of resulting take-or-pay costs that was also part of this settlement would remain intact.[14]

Thus, with respect to Great Lakes' situation, footnote 50 is inapplicable. *See* discussion *infra* re TransCanada at 85-87.

The second clarification requested by Great Lakes (at 26-27) pertains to prudence issues. The company asks the Commission to state that the prudence of any take-or-pay payments made by Great Lakes will not be an issue in its future rate proceedings, since all of its gas purchase contracts were approved by the Commission and the Economic Regulatory Administration (ERA).

The issue of whether or not prudence arguments lie with respect to Great Lakes' take-or-pay expenditures is beyond the scope of the instant Rule. Like the question of proper allocation of take-or-pay costs, the matter, if raised, can be resolved in the context of Great Lakes' rate cases.

Additional arguments raised by Great Lakes are dealt with in other sections of the instant order.

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[14] An example of such a settlement is Columbia Gas Transmission Corp. v. Texas Gas Transmission Corp., 24 FERC ¶ 61,049 (1983).

Tennessee Gas Pipeline, Inc. (Tennessee):

Tennessee makes a number of arguments on rehearing. First, it asserts that a rulemaking is a legally deficient procedure for changing a single portion of pipeline tariffs. Like Kentucky West's petition, discussed *supra*, Tennessee's petition argues that Order No. 380 makes section 5 findings with respect to Tennessee's tariff without evaluating the individual impact of that change on Tennessee's operations. Tennessee asserts that this violates the judicial standard that the Commission give "reasoned consideration" to the factors involved in such a tariff change, citing *Permian Basin Area Rate Cases*, 390 U.S. 747, 769 (1968).

The Commission did give reasoned consideration to the impact of the Rule on all pipelines. In acting generically it indicated its determination that no initial or reply comments had set forth an individual factual situation demonstrating that the Rule should not apply to that commenter.

Tennessee next asserts that Order No. 380 is not supported by record evidence in support of its conclusions with respect to long-term benefits of the Rule on full requirements customers. This assertion is incorrect, as demonstrated by the reply comments of Northern Illinois Gas Company (NiGas) as follows:

> These [full requirements] customers ignore the benefits which the proposed rule should produce. Total requirements customers can subject [pipelines] to only limited pressure to lower gas prices — their only bargaining chip is the possibility of load loss to alternative fuels, a loss which could impact them as severely as it would [the pipeline]. . . . [T]his pressure does not translate into financial motives for [the pipeline] to reduce its gas costs for residential users. Only the gas-to-gas competition created by the elimination or reduction in [the pipeline's] minimum bill will place continuous, direct pressure on [the pipeline] to ensure that the gas costs paid by its customers are competitive with the price paid by others.

NiGas Reply Comments at 6. *See* Reply Comments of Consolidated Gas Supply Corp. at 4 and Natural Gas Pipe Line Co. of America at 8-12.

Tennessee further asserts that "the Commission took no evidence on the effectiveness of the rule in forcing renegotiation with producers or the possiblities [sic] of success." In fact, the record reflects that producer-pipeline negotiations *are* affected by the presence or lack of minimum commodity bill assurances:

> Natural's situation illustrates the impact of a minimum commodity bill. Natural has no minimum commodity bill and its customers are free to reduce their takes at will. Therefore, Natural has had to maintain competitive prices. Natural has one of the lowest gas costs among major interstate pipelines and has resisted the temptation to acquire large reserves of high cost gas.

Natural Gas Pipeline Company of America, initial comments at 10.

Tennessee also argues that "there is not even speculation as to the remedy [to full requirements customers] if the pipeline has purchased prudently but nonetheless loses sales." To the contrary, the Order makes it clear that at least one "remedy" to lost sales is the recapture of such sales through lowering of price. The order also makes it clear that the interests and responsibilities of full requirements customers would be considered in determining the appropriate allocation of the pipeline's fixed costs.

Another Tennessee argument is that the Commission did not discuss "the issue of increased gas costs resulting from cutbacks on multi-vintage contracts." The problem, Tennessee contends, is that "producers will tend to cut back first on their cheapest vintages," in situations where a pipeline loses load and thus cuts its takes from producers. According to this argument, this will then cause the system average cost of gas to increase.

Tennessee apparently misses the point. A major reason pipelines lose load is that their prices are too high. Pipelines must therefore be encouraged to make this problem clear to their suppliers. Once suppliers understand that prices too high to meet the market cause ever-increasing load losses and ever-declining volumes of takes, their own best interests would dictate that they reduce those prices. Thus, a supplier's pursuit of a cutback approach that tends to *increase* prices would be totally contrary to its short- and long-term interest in selling its gas. *See* Order No. 380 at 21.

As explained in the comments of Michigan Consolidated Gas Company (Exhibit G, Statement of George R. Hall):

> In the long run, the result [of minimum commodity bills] is less gas being taken than economically desirable. This latter result occurs because overpricing of gas to premium customers that minimum commodity bills permit will lead those customers to make investments in capital equipment using fuels other than gas even though gas-burning capital equipment would be the cost-effective choice . . . . Increasing numbers of residential or commercial customers will make significant irreversible capital investments that would not be justified at the true competitive price of gas.

Exhibit G at 5-6.

Tennessee also argues that high load factor pipelines with little storage cannot be treated in the same manner as low load factor peak service pipelines with storage capacity.[15] In response,

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[15] Tennessee's argument offered in its initial comments is as follows. Pipelines that provide seasonal, peak service must invest in large amounts of storage. By contrast, pipelines that provide service at constant levels throughout the year, *i.e.*, base load service, must purchase sufficient deliverability from suppliers to meet these annual requirements. To purchase sufficient deliverability, base load pipelines must agree to take-or-pay obligations with their suppliers. Thus, the choice between becoming a base load and a peak load pipeline involves the choice between acquiring storage and incurring take-or-pay obligations. If the Rule is applied to pipelines

the Commission notes its reliance upon the comments of a Tennessee customer in this regard:

> Tennessee's comment that its system will be no more than a peaking system after the proposed rule is adopted is a gross overstatement. First, Consolidated and Columbia cannot abandon their storage facilities and simply rely on Tennessee's pipeline facilities to meet peak loads. Even at Maximum Daily Quantities there is insufficient deliverability to fully serve all customers on peak day. Second, pipelines could hardly be expected to abandon storage facilities in place to forego the advantages of being high load factor customers. Tennessee's initial comments, which emphasized the "worst case," reglected [sic] to mention that Consolidated, this past summer, despite the *force majeure* conditions it faced, never fell below 53% of maximum monthly contract entitlements from Tennessee under all of its rate schedules. This winter, Consolidated is taking CD gas at minimum bill levels of 66⅔%. This variation in takes is quite small and no way supports Tennessee's claim that it will become a peaking facility.

Reply Comments of Consolidated Gas Supply Corp. at 2. The Commission also notes that the operational differences between peak and baseload pipelines do not justify the potential collection of variable costs not incurred by either type. If Tennessee as a high load-factor pipeline does not incur additional take-or-pay in prudently serving its customers, it can seek to recover the carrying costs in its rates. If it wishes to maintain its status as a high load-factor pipeline, it must take whatever steps are necessary to insure that its gas is competitively priced.

A further Tennessee argument is that there is no evidence to support the Commission's assertion that minimum bills cause a failure to convey market signals between the producer and the

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that currently operate as base load systems, they could lose substantial load and cease to be base load systems. As a result, they might be forced to acquire substantial amounts of storage at considerable cost to avoid take-or-pay liability.

burnertip. In fact, the record contains ample evidence to support this conclusion. *See, e.g.*, initial comments of Peoples Gas Light and Coke Company at 5-6; San Diego Gas and Electric Company at 3; Mississippi River Transmission Corporation at 7-8; Washington Gas Light Company, Frederick Gas Company, Inc., and Shenandoah Gas Company at 6.

Tennessee next asserts that the Rule will unduly discriminate against it because "the portion of its market puts 'up for grabs' is much higher than some other pipelines." Again, this is a factor of which the Commission was aware when the Rule was promulgated. The Commission nevertheless determined that the reasons articulated at pages 14-27 of Order No. 380 for finding Tennessee's minimum bill unjust and unreasonable were not offset by any pipeline's individual competitive position in the industry.

Tennessee further argues its position that the "two-way street" obligation between a pipeline and its customers is "grossly unbalance[d]" by Order No. 380 and asks which of the comments noted on this subject were in fact adopted into the Commission's rationale. The Commission believes its Order was clear. It described certain commenters' submittals on this subject in order to describe the diversity of views that exist within the industry.[16] It then adopted the views of some commenters (*e.g.*, reply comments of Northern Indiana Public Service Co. at 4-5; UGI Corp. at 3-4; Natural Gas Pipeline Co. of America at 4-7) that the need for adequate planning to meet a service obligaton should not come at the expense of competition (Order at pp. 29-30).

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[16] This topic is one of current industry interest. For one commentator's consideration of whether the shift to a more competitive environment necessitates relaxation of the pipeline service obligation, *see* Reiter, *Is the Pipeline's Certificate Obligation an Impediment to Competition in the Natural Gas Industry?*, 5 JOURNAL OF ENERGY LAW AND POLICY, No. 2, 217 (1984).

Tennessee believes that, absent total minimum commodity bill assurances, it cannot reasonably plan its gas acquisition program to meet its service obligation. This argument might be more compelling if it were not an undisputed fact that not all pipelines *have* minimum commodity bills.[17] Yet these pipelines have managed to stay in business and purchase supplies of natural gas in order to meet thier service obligation. The record further reflects that a number of pipelines supported the proposed rule despite the existence of their service obligation. *See, e.g.*, initial comments of El Paso Natural Gas Company; Consolidated Gas Transmission Company; Natural Gas Pipeline Company of America; Mississippi River Transmission Corporation. Accordingly, there is ample record support for the Commission's finding that despite a pipeline's service obligation, collection of variable costs via minimum commodity bills is unjust and unreasonable.

As a final note on this subject, the Commission observes that a pipeline's service obligation to its customers will be an important consideration in individual rate cases when the question of responsibility for take-or-pay liability is at issue.

M.I.G.C., Inc. (MIGC):

MIGC states (at 2) that it was created as an outlet for casinghead gas[18] from a large oil producing area. It requests rehearing of Order No. 380 on the basis that its contracts with oil producers contain take-and-pay provisions that require MIGC to physically take and pay for all casinghead gas tendered by the producer. This casinghead gas makes up nearly all of MIGC's system supply. MIGC asserts that this factual situation sets its operations apart from other pipelines, since its

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[17] *See* initial comments of Columbia Gas Transmission Corp. at 2; Natural Gas Pipeline Co. of America at 10. Other major U.S. pipelines that do not have minimum commodity bills include Southern Natural Gas Co. and United Gas Pipe Line Co. (no variable costs in minimum bill).

[18] Casinghead gas is that produced from an oil well.

minimum bill to its customers is structured on a similar volumes-tendered basis. MIGC therefore concludes that the minimum bill Rule should not apply to its sales tariffs.

The Commission disagrees. The reasons that minimum commodity bills are unjust and unreasonable apply to MIGC regardless of the source of its gas supply. MIGC notes (at 2) that:

> the overriding aim of [oil] producers in contracting for the sale of casinghead gas is to provide a reliable market outlet for the gas to ensure that the production of oil can continue without interruption or curtailment.

Thus, by MIGC's own admission, the price of the gas is not the primary concern of its producers; marketing is. Under these circumstances, MIGC's producers should certainly be willing to price their gas in order to be competitive in the market. This goal should be particularly easy for MIGC and its producers to achieve in the case of some of MIGC's contracts, since MIGC's filings at the Commission demonstrate that approximately 33 percent of its gas supply comes from M.G.P.C., its production affiliate.[19]

Accordingly, MIGC has not demonstrated that its factual situation provides a basis for exempting it from the Rule; rehearing is denied. MIGC also sought a stay of the Rule pending rehearing on the merits. Colorado Interstate Gas Company filed an Answer in opposition on July 10, 1984. That Answer is incorporated into this record.

Texas Eastern Transmission Corporation (Tetco):

In addition to raising matters discussed elsewhere in this Order, Tetco asserts that if the Commission is to deal with pipeline minimum bills, it must also deal with producer take-or-pay. To do otherwise, argues Tetco, will unduly discriminate against pipelines and thus be arbitrary and capricious.

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[19] M.I.G.C. PGA Filing, Docket No. TA84-2-47 (PGA No. 84-2).

Tetco's argument (at 4-5) is premised upon its theory that "[i]n practial effect, producers take-or-pay provisions are no different from pipeline minimum bills," yet the Rule leaves Tetco with "virtually no assurance that its gas will be purchased," while at the same time "it has take-or-pay obligations that the Commission has let stand . . . ."

This issue raises an unsettled area of the Commission's jurisdiction. Under section 601(a)(1) of the NGPA, producers who sell certain categories of natural gas need no longer apply for Commission authorization of either the sale itself or the price/terms under which the sale takes place. Accordingly, there arises an issue as to what kind of authority the Commission possesses to alter the terms of producer take-or-pay requirements.[20] The Commission does, of course, have authority under section 601(c)(2) of the NGPA to limit pipeline passthrough of amounts paid to producers, but this authority is somewhat limited in nature. *See Columbia Gas Transmission Corp.*, 26 FERC ¶ 61,034 (1984). Other arguments can be made as to the Commission's potential jurisdiction over producer-pipeline contract terms. *See* discussion in "Take-or-Pay Provisions in Gas Purchase Contracts," Statement of Policy, FERC Stats. and Regs., Regulations Preambles ¶ 30,410 (1982).

This is a difficult legal question and one the Commission need not address in the context of this Rule. The purpose of the Rule is not to reduce or eliminate take-or-pay obligations (although this may well occur and the Commission encourages efforts to work out take-or-pay problems); it is to encourage pipelines (and, inevitably, their producer-suppliers) to institute market-responsive *pricing* of natural gas. The record in this proceeding indicates that the take-or-pay problem that has existed on many pipeline systems during recent years has often resulted from

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[20] The Commission clearly has continuing authority over producer sales contracts still governed by the terms of the Natural Gas Act, but these contracts generally do not present pricing problems.

markets lost due to the high cost of natural gas. *See* Order No. 380 at 12-13; comments of State of Michigan and Michigan Public Service Commission at 3-8. It is the Commission's belief that as prices drop, the reverse procedure will occur and take-or-pay problems will dissipate.

This does not mean, however, that the Commission necessarily supports high take-or-pay levels in producer-pipeline contracts. It is simply not essential that the take-or-pay issues be resolved here. It has taken nearly a full year for the Commission to consider and finalize a minimum commodity bill Rule.[21] This effort has resulted in regulations that take a major step towards resolving the problems surrounding natural gas pricing. To halt this effort now and institute an inquiry into producer take-or-pay issues would undoubtedly take another full year. In the meanwhile, pipelines would continue to be protected from competitive forces, and the Commission would not be fulfilling its Natural Gas Act mandate to protect consumers from excessive rates and charges. The Commission's decision to proceed by removing a restrictive provision from pipeline tariffs now is a policy judgment based on its experience in dealing with historical and current problems facing the natural gas industry and natural gas consumers. *See Superior Oil* v. *FERC*, 563 F.2d 191, 201 (5th Cir. 1977).

As noted above, Tetco asserts that "producer take-or-pay provisions are no different from pipeline minimum bills." This may be true, in a very general sense, in that both types of provisions were essentially designed to assure a particular level of recovery of fixed costs regardless of how much gas is purchased.[22] Granting that general similarity of purpose, the

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[21] The Notice of Proposed Rulemaking in this docket was issued on August 25, 1983. The Final Rule takes effect July 31, 1984.

[22] *See* Notice of Proposed Rulemaking in this docket, FERC Stats. and Regs., Proposed Regulations ¶ 32,334 (1983) at pp. 32,669-70, and Statement of Policy, "Take-or-Pay Provisions in Gas Purchase

Commission observes that such similarity is not removed by the instant Rule. Pipelines may continue to recover their fixed costs (including take-or-pay costs) in whatever manner they were collecting them before promulgation of the Rule, and thus they are not unduly discriminated against in favor of producers.

Midwestern Gas Transmission Company/East Tennessee Gas Company (Midwestern):

Midwestern requests rehearing or clarification with respect to the Rule's effect on "downstream" pipelines like itself. A downstream pipeline is one that purchases its gas supply (or a portion thereof) from another pipeline (an "upstream" pipeline) rather than from a producer. Midwestern notes that the total commodity charge it pays an upstream pipeline for purchased gas includes not only the upstream pipeline's variable costs but also a portion of its fixed costs. When this commodity charge is included in the downstream pipeline's rates, however, it becomes part of the cost of purchased gas and thus a variable cost to the downstream pipeline's customers. Midwestern asks the Commission to state that only the variable cost portion of the upstream pipeline's commodity charge be considered variable for purposes of the downstream pipeline's commodity charge. Midwestern also argues that to consider these upstream supplier costs as "purchased gas costs" for purposes of the Rule would place it at a competitive disadvantage vis-a-vis producer-supplied pipeline competitors.

The Commission considers the cost a downstream pipeline pays an upstream pipeline for gas to be a "purchased gas cost" regardless of what types of costs make up the total charge for the gas. As a "purchased gas cost," the entire amount paid for the gas is considered variable and is recovered through the purchasing pipeline's commodity charge. To treat purchased gas

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Contracts," FERC Stats. and Regs., Regulations Preambles ¶ 30,410 (1982) at p. 30,312.

costs in any other manner would constitute a departure from consistent Commission rate design practice.

The Commission notes that the requests to consider some of these purchased gas costs as fixed costs may partially stem from the downstream pipeline's desire to be able to charge its customers for these costs, even if the customers do not take gas at or above minimum bill level. The desire to collect for these costs is entirely reasonable, since the downstream pipelines do actually incur the upstream pipeline's fixed costs.

The Commission assures these petitioners that they will be able to recover the fixed costs they actually pay upstream suppliers. This recovery is assured not by the downstream pipeline's minimum bill, but by its Purchased Gas Adjustment (PGA) clause. For example, in the case of Midwestern, if it does not take the minimum bill quantity of gas from Tennessee in a given period, it must nevertheless pay the fixed cost portion of Tennessee's minimum commodity bill. This payment may then be recovered by booking it into Midwestern's Account No. 191 as a deferred cost and recovering it via Midwestern's PGA. This clarification should alleviate any concerns that recovery of this actual cost is at risk.[23]

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[23] SoCal raises a similar question, asking if deferred amounts in Account No. 191 can be included in a minimum commodity bill. In response, the Commission notes that the term "purchased gas costs" does include the Account No. 191 adjustments. Thus "purchased gas costs" are composed of both the current adjustment for projected costs and the deferred account surcharge component of Account No. 191.

The Account No. 191 mechanism is designed to reimburse the pipeline for purchased gas costs it has incurred in excess of the costs it projected in its previous PGA. To the extent there is an undercollection of such costs, that undercollection will be reflected by higher variable costs in the commodity charge when the next PGA period takes effect. To the extent there is an overcollection, it will be reflected by lower variable costs in the commodity charge in the next period. The Rule applies to the circumstances under which the variable cost component of the commodity charge can be collected.

Wisconsin Distributors Group (WDG)

WDG's members are full requirements customers of ANR Pipeline Company (ANR) (formerly Michigan-Wisconsin Pipe Line Company). ANR's largest customer is Michigan Consolidated Gas Company (MichCon), a partial requirements customer. In the introductory remarks to its rehearing petition (at 3), WDG states that under Order No. 380, MichCon would suffer "no penalty, no cost, no duty" were it to swing off the ANR system.

The Commission believes that WDG has overstated the case. Whether or not MichCon is taking gas from ANR, it must continue to pay its appropriate share of the fixed costs in ANR's rates. At a minimum, the existing demand charge and the minimum commodity bill covering fixed costs ensure that. Further, if after Order No. 380 takes effect ANR incurs take-or-pay costs and seeks to recover them in its rates, the Commission expects methodologies to be developed to assign, as accurately as possible, all prudently incurred take-or-pay costs to whatever customers were responsible for those costs. As the Commission stated in Order No. 380 at 44-45, it

> encourages its Staff to consider in individual rate cases whether and under what circumstances take-or-pay carrying costs should be allocated separately from other costs. The Staff's recommendations to the Commission in each case should consider all of the above-discussed factors [*e.g.*, can it be determined who caused the take-or-pay?], as well as any other factors Staff or the parties believe to be relevant.

Thus, if it can be determined that MichCon is responsible for take-or-pay costs resulting from contracts that ANR prudently entered into on MichCon's behalf, and that there are no other

countervailing considerations, MichCon would have a duty to shoulder any resulting cost burden.[24]

As to WDG's rehearing request, it raises the following matters. First, it asserts that the Commission is bound by the terms of the settlements it approved in two ANR rate cases that WDG participated in. WDG notes that one element of these settlements reduced the level of variable costs in MichCon's minimum commodity bill in exchange for MichCon's agreement not to seek any further reductions in this level until November 1, 1984. WDG argues that since the Rule relieves MichCon of *all* variable cost obligations in its minimum bill, MichCon gets relief it would not have gotten under the terms of the settlement and the benefit of WDG's bargain is reduced.

WDG misunderstands the Commission's Natural Gas Act authority. When the Commission approved the section 4 rate case settlements, it did so because it found their terms to be a reasonable resolution of the issues and in the public interest. *See Michigan Wisconsin Pipe Line Co.*, 26 FERC ¶ 61,090 (1984). Subsequent to that approval, the Commission completed its analysis of variable costs in minimum commodity bills and issued Order No. 380 under section 5 of the Naural Gas Act. The Order affects one element of *all* pipeline tariffs, including ANR's. Having found that the presence of this element in any tariff is unjust and unreasonable, the Commission was compelled by section 5 to remove it, regardless of how it got there. *See supra* at 9 and Order No. 380 at 49-50.

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[24] On a similar note, the Commission observes that it does not seem generally appropriate for partial requirements customers to oppose off-system sales by their pipeline suppliers to alleviate take-or-pay. These customers cannot have it both ways. They cannot expect their pipeline supplier to undertake gas acquisition programs on their behalf and at the same time oppose efforts by those pipelines to dispose of the gas elsewhere when these customers do not take it. *See* Order on Rehearing of Order Authorizing Off-System Sales, Natural Gas Pipeline Co. of America, ... FERC ¶ .... (1984) (issued July 30, 1984).

WDG further argues that since the Commission did not specifically condition ANR's settlements on the outcome of any future minimum bill rulemaking, it cannot apply the Rule to these settlements. WDG notes that when Panhandle Eastern Pipe Line Company submitted a settlement similar to ANR's with respect to minimum bill relief, the Commission specifically stated that any Rule in the instant docket would apply to Panhandle.

The Commission finds this a distinction without a difference. It is unnecessary for the Commission to put an individual pipeline (or its customers) on notice that section 5 findings may be applied to it on a prospective basis. The Natural Gas Act has already put all jurisdictional pipelines on such notice. The fact that in the Panhandle order the Commission thought to alert parties to the existence of an outstanding rulemaking does not in any way carve out the ANR settlement from the effect of the Rule.

WDG also asserts (at 16) that, as a matter of policy, the Commission should "avoid adoption of a policy that would encourage parties to litigate cases rather than settle them and risk losing their bargain." The Commission fails to see how Order No. 380 could have this result. The Order applies to all tariffs, regardless of whether their terms came about through uncontested filing, litigation, or settlement. If WDG had litigated a minimum bill case and had had its position prevail, the Rule would affect that litigated case just as surely as it affects a settled case. Thus the Rule simply cannot be said to discourage settlements in favor of litigation.

WDG further argues that the record in this proceeding is deficient because the Commission

> failed to update the record as to the current effect of eliminating variable costs from minimum commodity bills on renegotiations of gas contracts between pipelines and producers in light of the substantial voluntary reductions in

gas prices and modification of other contract terms that have occurred on particular pipelines since August 1983.

The Commission notes that it provided an opportunity for interested persons to file Reply Comments in this docket on or before February 13, 1984. If WDG felt that there was outstanding, post-August information on this subject that the Commission needed to consider before adopting a Rule, it could have submitted such information in Reply Comments. Yet WDG did not file any Reply Comments.

Other arguments made by WDG are considered elsewhere in the instant order; its request for rehearing is denied.

Pacific Interstate Offshore Company (PIOC):

PIOC asserts that Order No. 380 should be modified so as not to apply to pipelines like PIOC that have only one source of gas and only one customer (a partial requirements customer). PIOC explains that its only facility is an offshore pipeline bringing gas onshore from a single offshore platform. PIOC has no other gas supply. It resells all of its gas to its affiliate PLGS, which in turn resells to SoCal Gas, another affiliate. PIOC's volumes represent approximately two percent of SoCal Gas's purchases. PIOC asserts that these circumstances make PIOC unique and that the Rule should not apply to its tariff.

PIOC does not dispute that it will continue to collect its fixed costs at minimum bill level under Order No. 380. It is concerned, however, that the Rule could produce "all-or-nothing" purchases by SoCal/PLGS that would bring into question whether any take-or-pay prepayments to its producers could ever be made up. In this situation, "potential lenders will be unwilling to finance prepayments" (at 5).

The Commission finds that the Rule should apply to PIOC's tariff. While PIOC's operational setup may be more limited than that of other pipelines, its minimum commodity bill produces the

same unjust and unreasonable results as all other minimum commodity bills. The answer to PIOC's concerns is the same as the answer to the concerns of other rehearing petitioners. If PIOC's rates are too high to attract customers (leading to take-or-pay problems) it will need to find ways to reduce those rates in order to compete. In this regard, the Commission notes with favor PIOC's statement (at 6) that it "now provides healthy competition to other suppliers to the Southern California market."

PIOC asserts, however, that as a single-source pipeline it will have more difficulty negotiating contract concessions than the typical pipeline with numerous producers. The Commission does not find this argument compelling. PIOC's two offshore producers are in the same narrow position that PIOC is. These producers have no outlet for this gas other than PIOC. *See* 23 FERC ¶ 61,390 at 61,827. If they do not move the gas through PIOC, the gas does not move. Accordingly, it appears in the best interests of both producer and pipeline to ensure that this particular gas supply is competitively priced.

Pacific Offshore Pipeline Company (POPCO):

POPCO's factual situation as a single-supplier, single-customer pipeline is analogous to that of PIOC, and the PIOC discussion *supra* will not be repeated here. POPCO also asserts a procedural argument: it alleges that its cost-of-service tariff with project financing was beyond the scope of the Notice in this docket.

The Commission disagrees that the Rule strays beyond the bounds of the Notice. Nowhere in the Notice did the Commission state that it was limiting its inquiry to stated-rate tariffs, as opossed to cost-of-service tariffs. To the contrary, the Notice stated at p. 32,672:

> At this time the Commission contemplates that a final rule in this docket would: (1) apply to *all minimum commodity*

> *bill provisions in natural gas tariffs on file with this Commission* on the effective date of the rule . . . . (Emphasis added.)

But even if this language had not led POPCO to believe that its tariff could fall under the Rule, the Commission specifically mentioned project-financed pipelines, which in many cases have cost-of-service tariffs, in the Notice. It stated (at 32,673) its awareness that the Rule, as proposed,

> does not provide relief in those cases in which the terms of the project financing stand in the place of variable cost component of a minimum commodity bill.

This statement reflected the Commission's recognition that the proposed wording of the Rule, with its reference to variable costs "not incurred," would protect certain kinds of tariffs from the Rule's application. By definition, a cost-of-service tariff would not permit recovery of costs "not incurred." The Commission was not necessarily satisfied with this omission from the Rule, however. It asked (at 32,673) for comment on:

> whether some mechanism similar in effect to this proposal should be applied in cases of the project financed pipelines, and, if so, suggestions for the structure of such a mechanism.

Notably, the Commission did not set forth any reasons it believed such pipelines *should* be excluded from the proposed Rule; it merely recognized that the structure of the language would not encompass cost-of-service tariffs and inquired as to a formula for bringing them under the proposal.

Thus POPCO was on notice that the Commission was looking at *all* tariffs, but it could not be sure whether its tariff might end up falling under a restructured general rule, or might end up exempted because of its cost-of-service structure. In either case, however, POPCO knew that its tariff was under consideration.

While no commenter came up with a structure or mechanism to bring cost-of-service tariffs under the Rule, the Commission

developed one on its own by altering the wording of the Rule in a manner that would encompass all tariffs. This was clearly necessary, since the record demonstrated the unjust and unreasonable anticompetitive effects of minimum bill type provisons in all pipeline tariffs, *all* of which were within the scope of the proposed rule. None of the reasons set forth in POPCO's or other comments on project financing or on cost-of-service tariffs refuted these anticompetitive findings. Given these findings, it was necessary to ensure that all types of tariffs fell under the Rule. The Commission accomplished this by replacing the "costs not incurred" language.[25] Such a modification of language was well within the scope of the Notice and fully met the requisite legal standards. *See, e.g., Pennzoil* v. *FERC*, 645 F.2d 360, 371 (5th Cir. 1981).

Texas Gas Transmission Corporation (Texas Gas):

Texas Gas is another pipeline that seeks rehearing based on the argument that its own system does not fit within the general discussion contained in Order No. 380. Approximately half of Texas Gas' sales are for partial requirements service to five other interstate pipelines, all of whom have numerous other current or potential supply sources. The company asserts (at 3-7, 16-17) that in the absence of guaranteed purchases from these pipeline customers, it will be unable to project what level of purchases these five customers will require for any given year, and that the two-way obligation between Texas Gas and its pipeline customers would be "terminated" (at 10) by the Commission's Rule.

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[25] This was not the only reason for altering the "not incurred" language of the proposed Rule. *See supra* at 15-16.

This argument is unpersuasive. The reply comments of another interstate pipeline (which is one of the five Texas Gas pipeline customers) explain why:

> Against [the] beneficial results of its proposal, the Commission must weigh allegations of some commentators that adoption of the rule will make the management of gas supply difficult. There are several factors which assure the Commission that gas supply can be fully managed after the proposed minimum bill modification.
>
> The rulemaking proposal does not give customers infinite discretion in their purchasing patterns. First, there are the physical limitations. It would be a rare supply in this industry which can be shut off entirely for any annual period in favor of a cheaper supply . . . . Unlimited excess pipeline capacity is not available. Second, under the proposal, there still are significant economic disincentives to switch suppliers.
>
> Since fixed costs in the commodity [charge] will continue to be reflected . . . an alternate supply must be considerably cheaper before a switch in suppliers is economically justifiable. Third, the combination of demand charges and minimum commodity bills incorporating fixed costs, represents a sizable economic commitment by a customer. Over the long term, a customer will be unwilling to absorb costs of excess gas supply and facilities unless it believes such costs are outweighed by the cost savings due to the possibility of increased competition.

Reply Comments of Consolidated Gas Supply Corp. at 2-3.

The Commission relied on these and other comments in reaching its conclusion that pipeline planning needs did not outweigh the reasons for removing variable costs from minimum commodity bills.[26]

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[26] The Commission also notes that Texas Gas buys from a pipeline (United) that has no variable costs in its minimum bill, and sells to a pipeline (Columbia) that has been in business for many years without any minimum commodity bill.

Texas Gas also argues (at 7-8, 19-20) that even though its rates are currently "among the lowest of any interstate pipeline," some of its pipeline customers may, under Order No. 380, reduce their purchases from Texas Gas for reasons unrelated to rate level, such as meeting minimum take-or-pay requirements with producer-suppliers. In response, the Commission would simply note that the same argument could be made in the opposite direction by a producer offering lower priced supplies than Texas Gas. The pipeline customer might decide to buy from Texas Gas to meet its existing minimum commodity bill level, cutting back on lower priced takes from the producer. The issue of the prudence of pipeline purchasing practices and patterns has been at the forefront of Commission inquiry for the past several years. *See Columbia Gas Transmission Corp.*, 26 FERC ¶ 61,034 (1984). It is a matter that is individual to each pipeline and cannot and need not be an issue in the instant proceeding.[27]

Texas Gas further asserts (at 9-15) that although its comments reflect the uncontroverted fact that its gas is competitive in the market, the Commission "lumps" its system in with others that "presumably better fit the Commission's findings." This argument overlooks the fact that the Commission's findings *do* apply to all minimum commodity bills, even those of Texas Gas. While Texas Gas' current rates may indeed by competitive, what about its rates in the future? The Commission's concerns about restraints on competition and potential collection of costs not incurred could certainly come into play were Texas Gas' competitive position to change.

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[27] Texas Gas points to specific problems it asserts it is experiencing with one of its pipeline customers, Columbia Gas. The question of whether Columbia's purchasing practices constitute "fraud, abuse, or similar grounds" under Section 601(b)(2) of the NGPA, or are imprudent under sections 4 or 5 of the Natural Gas Act, is currently set for hearing in Docket Nos. TA82-121-001, *et al.*, governing periods from 1982 through 1984. *See Columbia Gas Transmission Corp.*, 26 FERC ¶ 61,036 (1984).

Texas Gas further notes (at 18-19) that since some pipelines may reduce their gas acquisition programs without the guarantees offered by variable costs in minimum bills, Order No. 380 will lead to curtailments. The Commission disagrees for the reasons set forth in Order No. 380 at 36-37. Texas Gas, however, also sees an analogy to the 1970s, when there was no surplus gas to meet customer demand. In response, the Commission notes that the chronic shortages of the 1970s were largely the result of two decades of wellhead price controls that resulted in a dual inter-intrastate market. In enacting the NGPA, the Congress determined that phased deregulation of wellhead prices would lead to increased exploration for and development of natural gas supplies. *See* Order No. 380 at 12. That determination proved correct, as today's deliverability surplus indicates. There is no evidence whatsoever in the record in this docket to indicate that the Rule will lead to a general decline in supply development. No producer came in and complained about the proposed rule. No one alleged that less natural gas would be sold in this country as a result of the Rule. (Indeed, the opposite is likely. *See* Order No. 380 at 21.) The record simply does not establish any nexus between the Rule and the events of the 1970s. The two situations cannot be compared.

Finally, Texas Gas asserts (at 25-26) that Order No. 380 constitutes "precipitous action" which does not provide sufficient lead time for system planning. The Commission would merely note that pipelines have been on notice since last August that the Commission proposed to implement the instant Rule. Thus they have had nearly a full year to plan their response. Under these circumstances, the Commission does not find the effective date of July 31, 1984, to be "precipitous."

Transcontinental Gas Pipe Line Corporation (Transco):

Transco suggests (at 2) that if the Commission's purpose "is to establish uniformity among pipelines," it should establish the same level of minimum commodity bill charges for competing

pipelines. The Commission notes in response that this proposal would not resolve the problem of potential collection of "costs" not incurred that was recognized in Order No. 380 at 14-19.

Transco also points to an experience it has had following a recent rate case settlement in which it agreed to eliminate the variable costs from its minimum commodity bill. It states (at 12, n.8, 6, and 4 n.3) that certain customers "have failed to pay their relatively low fixed cost only minimum commodity charges to Transco." Transco apparently relies on this situation as support for its position that variable costs should be retained in its minimum bill. The Commission finds this argument a red herring. If a Transco customer is refusing to pay its share of Transco's fixed costs, that is contractual dispute between the parties that simply falls outside the scope of this proceeding. It does not provide a basis for finding that Transco's existing minimum commodity bill is just and reasonable.

Transco further disputes (at 7) as "unsubstantiated" the Commission's conclusion that the Rule will help the industry move towards a competitive balance. In response, the Commission would refer Transco to, for example, the detailed economic analysis included with the initial comments of MichCon (Exhibit G, Statement of George R. Hall), which concluded, *inter alia*, (at 10-11):

> [The industry pricing] system is changing to a "net back" pricing system similar to the net back system in oil markets. Under "net-back" pricing the wellhead price is governed by the burner-tip price and not vice versa. In a net-back system price formation begins in the final demand markets. The need to clear the final demand markets — that is, to equate available gas supply with gas demand, which depends on the prices of the other fuels that customers can buy — determines gas prices in end-use markets . . . .
>
> [M]inimum commodity bills impede net-back pricing, because by maintaining apparent demand at artificially high levels, they confuse the market signals that need to

pass from the burner tip to the wellhead if a well-working competitive market is to be achieved.

Transco also argues (at 8) that there is "no evidence on the record" to support the proposition that if curtailment were to be threatened on a particular pipeline system, emergency procedures are available to move gas to that system. The Commission sees no need for record evidence when its own regulations provide for such procedures. Further, as noted *supra*, the Commission does not believe that this situation is likely to occur; its discussion of this subject was purely in response to a theoretical scenario raised by one comment.

Finally, Transco is concerned (at 10) that in promulgating Order No. 380, the Commission has increased Transco's business risk without recognizing the commensurate need for a higher rate of return. The answer to this concern is, of course, that if Transco believes it needs a higher return for this or any other reason, it can so demonstrate in a rate case wherein all factors bearing on its risk level can be duly considered.

Transwestern Pipeline Company (Transwestern):

Transwestern begins its petition by stating (at 1-2) that Order No. 380 "will cause more problems and surpass in effect and change all prior orders issued by this Commission and its predecessor in the history of pipeline regulation under the Natural Gas Act." In response, the Commission notes that these remarks should be considered in the context of Transwestern's 91 percent minimum commodity bill and 80 percent minimum take requirement. The record shows that these tariff provisions have caused serious problems for Transwestern's customers and competitors in the southern California market it serves. For example:

1. The proposed rulemaking would effectively lower gas prices to Southern California by removing major obstacles in the transmission of market signals and by

increasing competition between El Paso and Transwestern . . .

In SoCal's case, a minimum bill requirement of 91% of Transwestern's annual contract demand (CDQ) has prevented them from purchasing less expensive sources of available natural gas and, thereby, attaining a true least-cost supply mix . . . .

With the protection of their minimum bill, Transwestern remains insulated from the realities of the marketplace and apparently does not consider it necessary to remain competitive.

Initial comments of San Diego Gas and Electric Company (a customer of Southern California Gas Company (at 1-2).

2. . . . [A] pipeline company that is armed with a minimum bill provision such as the Transwestern 91 percent minimum mentioned above has no incentive to maintain its cost to California at the lowest reasonable level. The required minimum quantities must be taken whether or not such quantities can be marketed on a stand-alone basis.

Initial comments of People of the State of California and the Public Utilities Commission of the State of California (at 7-8).

3. El Paso has borne virtually the entire market reduction in California not because of price competition, but instead because of undue disparity in the contractual minimum bill/minimum physical take obligatons of El Paso, as compared with those of the other interstate pipeline suppliers to California . . . [Table attached to comments.]

Indeed, but for these minimum bill/minimum physical take provisions, El Paso estimates that the California consumer could have saved approximately $311 million in 1982 alone had El Paso gas been taken ahead of

more expensive gas supplied by PGT, PIT and TW [Transwestern].

Initial comments of El Paso Natural Gas Company at 6-8.

The record in this proceeding thus helps put into perspective the reaction of Transwestern to Order No. 380 and the wide-ranging arguments Transwestern makes upon rehearing. Many of Transwestern's arguments are discussed elsewhere in this Order or were dealt with in Order No. 380. In addition, however, the following require response.

Transwestern asserts (at 10-13) that this generic rule should not apply to Transwestern because in prior orders the Commission set the issues surrounding its minimum bill for adjudication before an administrative law judge, and those adjudicatory proceedings are still open. In response, the Commission notes its awareness that several Transwestern dockets, as well as a number of other pipeline dockets, have been set for hearing on their minimum bill issues. The proliferation of cases raising minimum bill issues was, in fact, one reason the Commission eventually decided to proceed generically on the issue. *See* Order No. 380 at page 46. It was the Commission's intent that the Rule in this docket resolve one major issue in all of these cases, *i.e.*, the presence of variable costs in minimum commodity bills. Other issues such as the presence of fixed costs and the percentage level of the minimum bill may remain to be adjudicated. *Id.* at pages 50-51. The fact that the Commission has set a matter for hearing does not preclude it from later resolving that matter (or a portion thereof) through a generic rulemaking.

Transwestern also asserts that it was improper for the Commission to proceed with this matter through rulemaking rather than by making individual factual findings. The Commission disagrees. For purposes of the Rule, the Commission assumed that the factual statements made by Transwestern (and others opposing the Rule) as to their operational situations, potential take-or-

pay liability, and similar factual matters were true. The Commission found that none of these factual matters overcame its own findings, based on the record, that variable costs in minimum commodity bills act as a restraint on competition and can result in recovery for costs not incurred. In fact, it is only these generic findings that Transwestern objects to. It objects to the fact that the Commission considered both initial and reply comments, weighed the record before it, and concluded that:

> if it were to proceed case-by-case to consider every minimum bill in every existing pipeline tariff, the issues would essentially boil down to the same ones considered in this rule, and the results could be expected to be the same as the result reached in this rule.

Order No. 380 at 49, n.53.

Transwestern has presented no factual situation that would justify reaching a different result.

Transwestern also sets forth (at 21-22) a string of citations to cases in which the Commission and/or the courts considered various minimum bill proposals, permitting a number to go into operation. It asserts that the Commission cannot disregard this precedent. The Commission notes, however, it is familiar with the functions traditionally served by minimum commodity bills. *See, e.g.*, Order No. 380 at 9-11. It nevertheless reiterates its findings that the role played by minimum bills has taken on new functions in the years following passage of the NGPA, functions that have caused the Commission to take a fresh look at minimum commodity bills.

Transwestern also makes an argument with respect to the Commission's findings that variable costs in minimum commodity bills lead to loss of load to alternative fuels. It argues (at 25-28) that since in California the state commission (CPUC) sets distributor prices for natural gas by reference to the price of alternative fuels, any fuel switching is dictated by the CPUC's policies.

Transwestern misses the point. Regardless of CPUC's ratemaking methodologies, that agency must begin with the price that California distributors pay Transwestern for gas, a price that the CPUC does not regulate. The CPUC may decide to let the distributors price their gas higher or lower depending on alternate fuel costs, but the commodity rate those distributors pay Transwestern nevertheless sets a floor or establishes the range within which the CPUC can operate (as noted in Transwestern's petition at 27). If the cost of the gas is too high, load that can switch will generally switch. Whether or not there is presently any such fuel switching in California, the potential is there regardless of the CPUC's methodologies. And that potential has become reality in a number of markets. *See e.g.*, initial comments of Gas Service Company at 2-3; State of Michigan and Michigan Public Service Commission at 6.

Thus the Commission's alleged "failure to address . . . vagueries (sic) of state regulatory action" (at 27) in no way represents a flaw in its reasoning.

Next Transwestern turns to the effect of Order No. 380 on Transwestern's take-or-pay liability. It notes (at 28-29) that if its customers were relieved of existing minimum bill obligations, Transwestern could expect approximately $290 million of take-or-pay liability to accumulate. It states (at 29) that the Commission has

> given no consideration to whether the speculative benefits of the rule outweigh the carrying charge burden that take-or-pay will place on the nation's consumers, even assuming, contrary to the hard facts, that the pipelines would be able to attract sufficient capital under the conditions created by Order 380. . . .

In Order No. 380 the Commission recognized that some pipelines may experience additional take-or-pay liability as a result

of the Rule.[28] It also recognized, however, that if one pipeline incurs additional take-or-pay liability, it will likely be because some *other* pipeline has increased sales at the first pipeline's expense. This would *reduce* the second pipeline's take-or-pay exposure. Thus, the "carrying charge burden" will not be placed "on the nation's consumers" as Transwestern claims; it may well, however, tend to be shifted among the consumers served by particular pipelines, depending on how well the various companies are able to adapt their operations to the needs of their respective markets. (For a discussion of how some pipelines have been handling take-or-pay liabilities, *see infra* at 59, 68-69.)

Transwestern further seeks rehearing (at 30-32) on the basis of a recent Commission decision in *Transwestern Pipeline Co.*, 27 FERC ¶ 61,255 (May 16, 1984). In that proceeding the Commission summarily affirmed the findings of an Administrative Law Judge (ALJ) that, "So long as the [91 percent] minimum bill provisions remain in Transwestern's tariff, Transwestern's gas purchase practices are reasonable" (27 FERC at 61,481). In making this finding, the ALJ noted that

> No one suggests, by reference to the evidence of record, that Transwestern paid more for gas from a given source, or ever agreed to any type of contract provision that was more favorable to the seller, than competitive circumstances dictated.

26 FERC at 65,018. Transwestern apparently relies on this statement as the basis for its conclusion that the case is inconsistent with Order No. 380. It points to Order No. 380's "conclusion" that "minimum bills cause pipelines to pay more for gas supplies than would otherwise be paid in a competitive environment." This statement is not an accurate paraphrasing of what

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[28] In discussing this issue, the Commission also noted its "general understanding that many pipelines are not making take-or-pay payments in any case." (Order No. 380 at 45, n.49.) Not one rehearing petitioner challenged this statement.

the Commission concluded. In fact, it concluded that with minimum bill protection:

> the supplier pipeline can continue to operate profitably without having to worry about keeping its gas costs at a reasonable level. . . .
>
> Removal of the insulating minimum commodity bill, on the other hand, places much of the risk of market loss on the pipeline. This risk creates an incentive for the pipeline to go back to its producers and convey the message that its customers will not buy gas, or will buy less gas, at such a high price.

Order No. 380 at 20-21.

Thus Order No. 380 was not saying that minimum bills have encouraged pipelines to act imprudently and pay producers more than the producer market dictated under the circumstances. (Transwestern was not acting imprudently *under the circumstances*.) Rather, the Commission was saying that it is the presence of minimum bills that has removed *both* pipelines *and* producers from the kind of competitive circumstances that would encourage both entities to price their product at level responsive to the ultimate consumer.

Transwestern further alleges that "Order 380 erroneously attempts to deregulate pipelines insofar as sales and contracts are concerned but to continue regulation insofar as price and the ability to earn an entrepreneurial return are concerned." This overstates the case. Under the Commission's regulation, most pipelines (including Transwestern) are permitted to collect a demand charge from their customers every month regardless of whether or not they sell any gas. Those with minimum bills are permitted to collect a given level of the fixed costs in their commodity charge regardless of whether or not they sell any gas. Under the Commission's purchased gas adjustment regulations pipelines are permitted automatically to increase their prices when their gas costs go up. They will earn a given return on equity if they sell their established level of projected sales, and

they can keep any additional revenues if they exceed that level. Under these circumstances, removing the pipeline's automatic ability to recover a given level of variable costs hardly equates to deregulation of the industry.

Transwestern also asserts (at 40-42) that Order No. 380 is contrary to the NGPA because it allegedly disadvantages interstate pipelines vis-a-vis intrastate competitors, recreating dual market barriers the NGPA was designed to eliminate. The very items quoted by Transwestern in support of this proposition, however, make it clear that the major objective of the NGPA was to eliminate the pricing disparities between the interstate and intrastate markets. Such pricing disparities in fact led to the interstate market's historic undervaluation of natural gas as a commodity, to overconsumption, and to the need for interstate pipelines to curtail deliveries on the one hand while offering non-price terms as a negotiating tool for new supply on the other. The Congress correctly assumed that if wellhead prices were deregulated the dual market would be gradually eliminated. The Congress never mentioned the necessity of maintaining minimum bills or any other tariff conditions in order to keep a parity between interstate and intrastate markets. Indeed, it could not have intended to rely on such a distinction, since not all interstate pipelines have minimum bills. But that is not the question. The question is why would any customer with a choice be attracted to a pipeline if it had to agree to a minimum bill in order to get the service? Would it not rather arrange to purchase from another pipeline where it would have flexibility if that pipeline's gas were no longer competitively priced? And if so, why would any competitive intrastate pipeline make a minimum commodity bill part of its tariff? Not because it is necessary in order to compete with interstates for gas supply — Order No. 380 has taken care of that.

Transwestern further alleges (at 42-43) that it is "absolutely certain" to underrecover its prudently incurred costs under the

Rule, in contravention of judicial pronouncements that pipelines are entitled to recover their prudently incurred costs plus a return. The Commission fails to understand, however, how Order No. 380 places Transwestern in a regulatory position that differs from the one it was in prior to Order No. 380's promulgation. Prior to the Order, if Transwestern experienced increased take-or-pay costs, it was free to file a rate case with the Commission. The Commission could then evaluate all of the company's costs and revenues based on the "test period" approach, under which the Commission utilizes actual historical ("base period") data and then updates it for known and measurable changes reasonably expected to occur after the end of the historical base period. Any higher take-or-pay costs, actual or measurable for the future, thus could be factored into Transwestern's rates. This traditional regulatory procedure is in no way changed by Order No. 380. Transwestern simply anticipates that its take-or-pay costs will be greater.

Transwestern is troubled (at 43-44), however, by the Commission's alleged position that, in Transwestern's words "it will not allow pipelines to recover some portion of the carrying costs on their take-or-pay liability, even though this liability may have been prudently incurred." This allegation distorts the reality of the way take-or-pay liability is actually accrued and paid. In almost all producer contracts, take-or-pay liability is determined on an annual basis. Thus, while Transwestern may accrue take-or-pay liability on paper, that paper liability is adjusted upward or downward each month depending on how much gas Transwestern takes from such producer. Any liability remaining at the end of the contract year then may become actually payable. Even then, pipelines and producers have often managed to find ways to defer or otherwise resolve actual payment. *See* Appendix B for some examples.

Thus, the Commission's statement that, under a suspended rate case filing, the pipeline itself would carry any increased

take-or-pay costs, must be taken in context of the Commission's knowledge of pipelines' flexibility to manage their take-or-pay during a suspension period, when there is an incentive to do so, just as they would manage any *other* increased cost that occurred while a new rate case was pending. None of the cases cited by Transwestern stands for the proposition that the Commission must protect pipelines from new risks that may arise from rate case to rate case. *See, e.g., F.P.C.* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145, 152 (1962).

Finally, of course, if a rate case filing shows that a company is in a severe financial situation, the Commission can suspend its rates for one day rather than five months. The Commission has done this in cases where the circumstances so warranted.[29]

Arkansas Louisiana Gas Company (Arkla):

Like many other petitioners, Arkla alleges that there are numerous factual issues surrounding its minimum bill, in this case issues relating to its major jurisdictional customer, Northwest Central Pipeline Company. It asserts that since the Commission set many of these issues for hearing last year, it cannot now resolve them by rule.

The Commission finds that the conclusions and principles arrived at in Order No. 380 apply to Arkla despite the factual issues (such as the prudence of this customer's purchasing practices) that Arkla views as relevant to its minimum bill disputes with its customer.

Arkla also alleges (at 16) that the Commission's findings "have no applicability to Arkla." For example, the Commission found that minimum bills that recover variable costs not incurred have an anticompetitive effect. To support its proposition that this finding does not apply to Arkla, the company cites

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[29] *See, e.g.*, National Fuel Gas Supply Corp., 23 FERC ¶ 61,166 (1983); Montana-Dakota Utilities Co., 28 FERC ¶ 61,060 (1984); Locust Ridge Gas Co., 27 FERC ¶ 61,479 (1984).

numerous cases in the past where the Commission sanctioned minimum commodity bills. But Order No. 380 did not find that minimum bills are anticompetitive; it found that the ability to collect *variable* (not fixed) costs via a minimum commodity bill requirement is anticompetitive. The cited cases simply do not address this discrete issue, which has only become significant since passage of the NGPA.

The Commission also found that potential recovery of unincurred costs was unjust and unreasonable. To support its proposition that this finding does not apply to Arkla, the company argues (at 23-24) that "retention of moneys for which costs are not incurred is not *per se* unlawful under the Natural Gas Act." Arkla observes that this possibility exists in every rate case. The Commission, however, sees a large distinction here. If a pipeline's rates are properly designed, it should recover all of its costs plus its allowed rate of return. That is the basic premise of cost-based ratemaking. Certainly the possibility and incentive exist that if a pipeline sells or transports volumes in excess of those upon which its rates are designed, it will earn extra revenue. The possibility also exists that if it improves its operational efficiency it will earn extra revenue. But the Commission attempts to design rates that are as accurate as possible so as to ensure that these rates reflect what the pipeline will actually expend. Again, this is the way cost-based utility rate regulation works.

By contrast, a tariff provision containing a mechanism under which it is clear, up-front, that a pipeline could collect large sums of money for "costs" it never incurs is the antithesis of cost-based ratemaking. Such a provision does not encourage efficiency but instead blunts the incentive to be efficient. This type of provision exists in Arkla's tariff and was found unjust and unreasonable by Order No. 380. Arkla thus does not have a basis for argument that the Commission's findings do not apply to its own tariff.

Cascade Natural Gas Corporation, Northwest Natural Gas Company, Washington Natural Gas Company (NW Distributors):

These three companies are full requirements customers of Northwest Pipeline (NW). They seek rehearing on a number of issues, most of which have already been discussed *supra* or were fully dealt with in Order No. 380. In addition to those issues, the NW Distributors explain (at 9) that Northwest's system has a "bottleneck" that restricts physical flow between its domestic supply sources in the south and its Canadian supply sources in the north. NW's two partial requirements pipeline customers are located in the southern area of the system, while the NW Distributors are in the northern area. NW Distributors assert (at 5-7, 9-10) that if, as a result of the Rule, These two pipeline customers decide to decrease their takes, NW, for physical reasons, would have to cut back its takes of cheaper domestic gas, thereby raising the system average cost of gas.[30]

The Commission does not find that NW's physical configuration provides a basis for exemption from the Rule. NW's tariff presents the same unjust and unreasonable aspects as other pipeline tariffs with respect to minimum commodity bills.[31] Further, the issues surrounding NW's physical setup were fully deliberated in a recently adjudicated proceeding at the Commission. *Northwest Pipeline Corp.*, 23 FERC ¶ 63,079, *aff'd* 27 FERC ¶ 61,012 (1984). In that proceeding the ALJ found that, regardless of gas cost differences, a distinction simply could not be

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[30] The petition states (at 6) that NW's presently effective rates are based on domestic gas at an average cost of $2.57 per MMBtu and Canadian gas at an average cost of $4.17 per MMBtu.

[31] In this regard, it should be noted that the two pipelines who have the ability to swing off NW's system would have an incentive to do so if they did not need the gas, or if it would lower their *own* system average cost of gas to buy elsewhere. In either case they and their customers would benefit from such a swing.

made between domestic and Canadian suppliers for purposes of overall system benefit. He observed, *inter alia*, that:

> Northwest's major domestic supply enters at the southern end, while Canadian gas enters from two points at the northern end. Domestic supplies also enter it at the mid-point. Customers are located all along the pipeline, which creates substantial fluctuation of the no-flow [bottleneck] point of gas . . . . [T]he availability of gas supplied from both the northern end and southern end benefits all of Northwest's customers.
>
> It is clear that Northwest's Canadian gas supplies benefit all of the pipeline's customers and that it is not possible to link specific customers with specific supplies.

Thus, for purposes of general system supply pricing, it has been determined that a link cannot be established between specific customers and specific supplies, regardless of how those supplies fluctuate. Rather, the answer to any system average cost problem is the same as it is for other pipelines: NW will have to make efforts to keep its system average cost of gas competitive in order to retain its partial requirements customers.

The NW Distributors also argue (at 15) that the Rule is deficient because it has not resolved the question of potential take-or-pay impact on a generic basis, "but has left such determinations to the *ad hoc* case by case method which is dependent upon the affected pipelines making a Section 4 filing." There are two responses to this argument. First, there cannot be any take-or-pay impact on the NW Distributors until NW *does* make a section 4 filing to change its rates. Thus, to imply that there will be immediate take-or-pay impact that must await relief in a section 4 case is inaccurate. Second, the reasons for not attempting to dictate a generic method of take-or-pay cost allocation to NW are exactly the reasons the NW Distributors point to elsewhere in their petition: the unique characteristics of NW's system. It is at this point that the "bottleneck" arguments may become relevant. Thus, a methodology

that might achieve equitable results for another pipeline might not achieve those results for NW.

Finally, the NW Distributors assert (at 17) that:

> if Northwest cuts back on its Canadian supply when the two partial requirements customers swing off the system, it would be *physically* unable to supply the Northwest Distributors if those partial requirements customers come back on the system. Under these circumstances, the Commission should provide some guidance on whether Northwest would be entitled to reduce its service obligation when those customers swing back on the system.

This is an odd argument in light of the NW Distributors' previous assertions that 1) the swing customers physically take gas from the south, and 2) if the swing customers leave the system, "they will disrupt Northwest's ability to maximize its use of the lower cost domestic production" (at 7). In the above-indented statement, the NW Distributors seem to be asserting the opposite, saying that if the swing customers leave the system NW will cut back on its Canadian supply (presumably *lowering* average system cost).

In any event, the Commission believes that the physical configuration of the NW system does not present an insurmountable obstacle to system planning. NW's purchasing decisions will, as before the Rule, have to take into consideration both supply and price considerations. If take-or-pay must be paid to keep sufficient Canadian gas available, all customers should share in that obligation, in whatever manner is determined equitable in the rate case wherein NW seeks to recover the take-or-pay.

Most importantly, the pricing disparities between Canadian and domestic natural gas that present most of the problems foreseen by the NW Distributors could be greatly alleviated by the new Canadian Government export policy announced on July 13, 1984. *See infra* at 91.

Panhandle Eastern Pipe Line Company/Trunkline Gas Company (Trunkline):

In addition to arguments raised by others, Trunkline asserts the following. It alleges (at 5) there were "factual defects which could be demonstrated only through a hearing" in the initial comments filed by Consumers Power Company, which comments were cited in Order No. 380. In response, the Commission notes that Trunkline was given an opportunity to respond to these comments. Nowhere in its reply comments did it even mention the initial comments of Consumers Power, much less allege factual defects.

Trunkline also asserts (at 5-6) that the Consumers Power settlement example in the Order at 15, n.19 represented "a non-instance of detriment to any distributor or customer." The Commission, however, intended the comments to demonstrate an ongoing problem. The settlement does not reach beyond the end of 1984. As Consumers Power points out (at 6):

> Under its settlement minimum bill, which excludes variable costs not actually incurred, Consumers Power will make a minimum bill payment of approximately $19,000,000 owing to this shortfall [in volumes taken]. However, the minimum bill provision that would have applied if not for the settlement and that will become effective once again after 1984 does not exclude variable costs and would call for payments of approximately $270,000,000. Trunkline's minimum bill provision would therefore grant a windfall of approximately $251,000,000.

Thus, the fact that a "non-detrimental" settlement was reached regarding the variable costs in Trunkline's minimum bill does not relieve its customers of the minimum bill tariff provision that is reinstated upon expiration of the settlement. The instant Rule would actually change the tariff to provide permanent relief for Trunkline's customers.

Trunkline further complains (at 7) that the Commission failed "to take even the most minimal step in the direction of assisting

pipelines to survive the extirpation of their minimum commodity bills." In response, the Commission notes that Order No. 380 clearly explained the Commission's reasons for not establishing an automatic take-or-pay cost tracking mechanism such as Trunkline seeks. This is explained once again *supra* at 16. This does not mean, however, that pipelines are helpless to deal with their take-or-pay costs or obligations. First, as noted *supra* at 35-36, they can seek to recover these costs from their customers in a section 4 rate case. Second, they can seek to alleviate the obligations themselves. Over the past few years the Commission has observed a variety of approaches that pipelines have implemented to deal with their take-or-pay obligations to producer suppliers. Some have renegotiated their contract terms.[32] Some have released their suppliers from contractual commitments of gas supplies (at the same time providing transportation so the suppliers could sell the gas in certain spot markets on a discount basis).[33] Some have utilized the Commission's blanket transportation certificate program for this purpose.[34] Some have instituted cutback plans.[35] Some have sold excess gas off-system to customers outside their traditional market areas.[36] Some have cut their rates by reducing their margins in order to increase sales.[37] The point is that the Commission has already observed innovative and creative responses to the take-or-pay problems

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[32] *See, e.g.*, Appendix B.

[33] *See, e.g.*, Transcontinental Gas Pipe Line Corp., *et al.*, 25 FERC ¶ 61,219 (1983), 26 FERC ¶ 61,029 (1984).

[34] *See, e.g.*, Application of Columbia Gas Transmission Corporation, Docket No. CP84-461-000 (filed June 1, 1984) at 6-7 (noting that Columbia is transporting approximately 290,000 Dth per day under blanket certificate program and regular section 7(c) certificates).

[35] *See, e.g.*, Tennessee Gas Pipeline Co., Docket No. RP83-109, "Complaint, Request for Evidentiary Hearing and for Expedited Consideration, and Petition for Declaratory Orders."

[36] *See, e.g.*, Natural Gas Pipeline Co. of America, 27 FERC ¶ 61,235 (1984).

[37] *See, e.g.*, United Gas Pipe Line Co., 27 FERC ¶ 61,349 (1984).

that have faced many pipelines in the past few years. Experience has demonstrated that one such innovative approach can lead to others.[38] As the industry moves to a more market-responsive environment, take-or-pay problems can be expected to wane.

Trunkline also asserts that the Commission's concern about cost overrecovery is undercut by its statement in Order No. 380 (at 42) that minimum bills "seem designed to prevent take-or-pay prepayments from being incurred in the first instance, by discouraging customer cutbacks." Trunkline argues (at 8) that this statement somehow means that partial requirements customers "do *not* pay the pipelines for gas which is not taken."

The record is to the contrary. The initial comments of Trunkline's own customer, Consumers Power (at 5-6), demonstrate the potential it had (and has in future) for being charged for gas it has not taken. *See* initial comments of North Penn Gas Co. at 2. Trunkline further complains (at 9) that the Commission has not cited instances where minimum bill payments were actually made for gas not received. The Commission refers Trunkline to the PGA filings of Mississippi River Transmission Corp. (MRT) in Docket Nos. TA83-1-25-004 (Jan. 28, 1983) and TA84-1-25-000 (Jan. 30, 1984), which demonstrate that MRT paid United approximately $1.3 million for gas costs not incurred, which sum was refunded a year later after United's minimum bill case was settled. 25 FERC ¶ 61,088 (1983).

Trunkline also asserts (at 9-10) that minimum commodity bills:

> if they are causing partial requirement customers to purchase the gas they agreed to purchase, are accomplishing exactly what they were intended to do . . . . It is only

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[38] For example, the *Transco* program cited at n.33 eventually led to special marketing programs involving numerous pipelines, including Panhandle. *See PanMark Gas Co., et al.*, 26 FERC ¶ 61,341 (1984).

> under such economic conditions as presently exist that minimum commodity bills were intended to be operative.

If this was indeed the reason for including variable costs in a minimum commodity bill, it demonstrates that the real purpose of pipeline minimum bills is to force customers to buy gas even when uneconomic, so that the pipeline is protected but the customers pay uneconomic prices when reasonably priced supplies are available through other suppliers. This is one major concern that Order No. 380 was addressing. So long as minimum commodity bills exist in their present form to force customer payment even when the gas is unmarketable, the pipeline (and its producers) can be indifferent to actual market demand.

Trunkline also objects (at 10-11) to the Commission's observation in Order No. 380 that customers can challenge in rate cases the prudence of pipeline purchasing practices. This statement however, does not represent anything new to Trunkline. Indeed, the company's own purchasing practices have for some time been the subject of precisely such a challenge from both customers and members of Congress. *See, e.g., Trunkline Gas Company*, 26 FERC ¶ 61,363 (1984).

Trunkline further asserts that the Commission overlooks "the true intent of the NGPA, which was to increase the price of gas so as to encourage additional production and deliverability." It then blames this "intent" for the take-or-pay and minimum bill problems confronting the industry. The Commission has never understood Congress' intent to have been to *increase* the price of gas. Rather, it has understood that intent to have been to *deregulate* over time the price of gas so that the market, rather than artificial restraints, would determine gas prices, allowing them to increase *or* decrease. Order No. 380 is fully consistent with the Commission's understanding of that Congressional intent.

ANR Pipeline Company (ANR):

ANR seeks rehearing, alleging (at 3-4) that the conceptual basis of the Rule is flawed. It asserts that while the theme of Order No. 380 is the fostering of competition, "pipelines are not free to cut prices." As examples of this perceived flaw, it cites its requests to institute a special discount rate schedule and to make blanket off-system sales, neither of which has been approved by the Commission.

The two examples cited by ANR were filed in 1982, a period during which the Commission was attempting to formulate policies and approaches appropriate to the changing natural gas industry. At that time the Commission was proceeding cautiously, and programs such as special discount rates were being set for hearing to give the Commission the benefit of a more detailed look and an ALJ's analysis. Thus ANR's special discount rate proposal was set for adjudication.[39] Recently, however, one of these cases was finally decided. In *Northern Natural Gas Co.*, 27 FERC ¶ 61,299 (1984), the Commission approved a special discount rate schedule similar to that proposed by ANR. The *Northern* case should give ANR and other pipelines guidance in structuring their own proposals.[40]

As for off-system sales, the Commission notes that while it did not approve ANR's blanket request, it did approve a number of case-specific off-system sales for several pipelines (including ANR in Docket No. CP81-221). Recently, in *Natural Gas Pipeline Company of America*, 27 FERC ¶ 61,235 (1984), the Commission approved off-system sales at a rate below that previously

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[39] At the same time, however, ANR was authorized to make discount sales under a temporary certificate. Michigan Wisconsin Pipe Line Co., 21 FERC ¶ 61,054 (1982).

[40] The Commission notes that on June 26, 1984, ANR filed with the ALJ a proposed settlement that would approve its special discount rate schedule in Docket No. CP82-542. The settlement was certified to the Commission on July 20, 1984.

established in its off-system sales policy statement, utilizing a "net economic benefits" test to reach that result. That case, too, should establish helpful guidelines under which ANR may wish to develop an off-system sales program.

These cases demonstrate that ANR's premise is incorrect; the Commission *is* attempting to find ways that pipelines can reasonably compete within the regulatory framework.[41]

ANR further argues (at 5) that present competitive conditions do not require elimination of variable costs in minimum bills. Rather, ANR asserts, "It is the Commission, not competition, which threatens to eliminate those bargained for contractual provisions." In fact, the Commission only instituted the instant rulemaking after numerous complaints were filed by pipeline customers alleging that market conditions required minimum bill relief. *See* Order No. 380 at 46; Initial comments of State of Michigan, Appendix F.

ANR expresses the concern (at 8) that partial requirements customers, instead of turning from one pipeline to another, "will instead buy from producers in distress, which will not help *any* pipeline's customers." The Commission initially observes that cheaper gas would, of course, help *some* customers. But ANR's allegation also overlooks the fact that the customer cannot get the producer's gas from the wellhead to its own system without the cooperation of one of its pipeline suppliers. Since interstate pipelines are not common carriers, they are not required to transport this gas. Order No. 380 was intended to result in customers having a choice among pipeline suppliers. It was not intended to set up a producer-distributor sales/transportation

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[41] The Commission can act quickly when circumstances dictate. *See, e.g.*, United Gas Pipe Line Co., 27 FERC ¶ 61,349 (1984) (rate reduction approved less than 30 days after filing where United proposed to cut its price by reducing its margin).

program, nor did it establish any mechanism to implement such a result.[42]

ANR also has a problem (at 11-12) with another of the premises of Order No. 380: that variable costs in minimum bills inhibit market signals and give pipelines little incentive to make their gas costs market responsive. First, ANR alleges that the market signals resulting from the rule could give producers "more bargaining leverage" because of "more 'apparent demand' for gas." ANR seems to be arguing that partial requirements customers will be enticed from pipeline A to pipeline B by the latter's paying producers higher prices. This does not appear plausible.

Second, ANR asserts that it is not true that pipelines lack strong incentives to maximize sales. This statement is questionable, however, in light of the record established in Michigan Wisconsin (ANR) Docket No. RP82-80, *et al.*, wherein a key element of two settlement agreements filed by the company was the "benchmark incentive," a device under which the pipeline is financially rewarded if it reduces its gas costs below a benchmark level and penalized if it increases them above that level. This device was proposed by ANR's customers, and comments were filed in that docket by, *inter alia*, the Wisconsin Distributors Group, a group of full requirements customers who join ANR in opposing Order No. 380.[43] These comments reflect a perceived need to establish incentives that will encourage ANR to keep its gas costs low:

> To put it bluntly, this mechanism would give Mich Wis a concrete financial incentive [to] lower its purchased gas

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[42] ANR's argument also assumes static conditions, and that there will be no response by pipelines and producers if customers seek to buy cheaper gas elsewhere. The Commission's experience is to the contrary. *See supra* n.38.

[43] *See* WDG *supra* at 35.

> costs while retaining most of the benefits of any purchased gas cost reduction for the pipeline's customers.

WDG Initial Comments filed June 23, 1983, at 9.

> It does not necessarily follow, as Staff tries to suggest, that Mich Wis 'has no choice' but to decrease gas costs in order to retain interruptible loads .... Staff's approach simply *assumes* that the pipeline will act to reduce gas costs to save interruptible customers, whereas the objective of the proposed settlement is to *motivate* the pipeline to take certain actions that will benefit gas consumers. (Emphasis in original.)

WDG Reply Comments filed July 5, 1983, at 15.

All of ANR's customers supported this "benchmark incentive" concept, which was eventually approved by the Commission for a limited period. 26 FERC ¶ 61,090 (1984). Thus, it is clear that while ANR may not think it needs any incentives, its customers believe that incentives are needed to "motivate" the pipeline to keep its gas costs reasonable. The Commission believes, in turn, that the instant Rule will provide a different type of incentive for ANR (and others) to be responsive to market forces.

Algonquin Gas Transmission Company (Algonquin):

Algonquin asserts that the Rule cannot apply to its rate schedules, because no specific findings were made as to those particular "unique" documents. It notes that its only minimum bills are in two rate schedules governing winter peaking service (which service reflects less than 12 percent of its sales).

Under Algonquin's WS-1 service, it sells winter service gas it purchases from Tetco[44] under a corresponding Tetco rate schedule. Algonquin asserts (at 23) that under the Rule, its customers could substitute its cheaper, general service F-1 rate

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[44] Algonquin is a wholly owned subsidiary of Algonquin Energy Inc., of which 28 percent is owned by Tetco. Algonquin Gas Transmission Co., Docket No. CP82-119-000, Exhibit D.

schedule gas for the WS-1 gas, thereby reducing the revenues Algonquin was counting on.

The Commission fails to see how this causes Algonquin a problem. As noted *infra*, Algonquin, as a downstream pipeline, can include in its PGA any fixed costs it pays Tetco for winter service gas not taken. Then, if its customers switch to the F-1 schedule, they will still be buying from Algonquin and Algonquin will still be recovering both its fixed and variable costs from these customers. The variable cost component of its rates will reflect whatever costs are in its PGA.

Algonquin also has a rate schedule SNG-1 governing sales of synthetic gas manufactured by its affiliate, Algonquin SNG. Algonquin asserts (at 24-25) that its affiliate has made a commitment to purchase a certain amount of naptha feedstock based on its expectation that its customers would have to take a certain level of gas. Again, Algonquin is concerned that its customers will substitute cheaper F-1 gas for SNG-1 peaking gas, imposing a "substantial adverse impact upon the viability of the SNG operation."

In this situation Algonquin will have to tailor its SNG operation to the actual needs of its customers for this service, and this may require renegotiation of price and/or terms with its naptha supplier. This places Algonquin in a situation similar to that of pipelines who have contractual commitments with producers; adjustments may have to be made in order to meet market demand. In short, there is nothing about Algonquin's winter service rate schedules that would exempt these tariff provisions from the findings of Order No. 380.

Algonquin next argues that Order No. 380 will have an adverse impact on Algonquin as a full requirements customer of Tetco. It asserts that if other customers shift *more* of their load to Tetco, this raises the spectre of more rapid depletion of Tetco's existing reserves.

In response, the Commission would note that Algonquin is not the only customer with a previously established call on Tetco's gas. Tetco's other customers can legitimately increase their demand for Tetco's gas up to the levels at which Tetco is already certificated to serve them. If any customers wish to increase these levels, section 7 filings will have to be made, and Algonquin can then make its views known in the proceedings surrounding those filings. As for any overrun gas service, again Tetco's tariffs contain previously established terms under which its customers can legitimately ask for service. These terms existed prior to the Rule and customer requests for additional gas could occur with or without the Rule.

Algonquin expresses concern (at 40) the the Commission refused to consider expert testimony in various pending cases that "explains that the purpose of minimum commodity bills is to assure the economic viability of pipelines . . . ." The Commission notes that it is familiar with the record in these various cases and that these arguments were taken into consideration before reaching the conclusions that Order No. 380 reached.

Algonquin submits (at 61) that the findings made in Order No. 380 with respect to the long-term benefits of the Rule to all pipeline customers are "without record support, completely unsubstantiated by any reasoned analysis." It further complains that the Commission did not engage in any kind of economic analysis of the effects on the industry.

The Commission would respond in two ways. First, on its face, no economic analysis is needed to determine that the provisions allowing payment for "costs" not incurred are unjust and unreasonable. *See* Order No. 380 at 14-19. Second, with respect to analysis of the economic effects of the Rule, at least two commenters submitted economic analyses[45] and both supported

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[45] *See* initial comments of Michigan Consolidated Gas Co., Exh. G (fully supporting the Rule) and Federal Trade Commission Staff (supporting the Rule with qualifications).

the Rule. Algonquin was free to submit any study that it felt would be useful to the Commission's deliberations.

Algonquin also expresses (at 75-77) concerns about gas supply under the Rule. It asserts that the effect of the Rule will be "to discourage new production while increasing the rate of depletion of the older cheaper supplies." Algonquin may be correct in the short-term. However, the key question is not whether the Rule will encourage more production (or less), but rather whether it will tend to encourage the amount of production required to satisfy long-term demand for natural gas at competitive prices. The Commission believes that the Rule will lead in this direction because it will encourage parties to negotiate contracts that will permit the wellhead price of new production to reflect actual market needs, both in terms of quantity and price. Algonquin seems to assume that industry contracting practices in a deregulated atmosphere will remain exactly as they were under federal regulation. The Commission believes this too narrow a view.

Finally, Algonquin reminds the Commission (at 10) that under section 5 *all* rates must be just and reasonable. It asserts that since Order No. 380 acknowledges that there may be offsetting benefits and detriments from pipeline system to system, all rates will not be just and reasonable.

In Order No. 380 the Commission removed a tariff provision that it found to be unjust and unreasonable as to all pipelines. In acknowledging that uniform removal of this provision could affect different pipelines differently, it was not concluding that these differences would create unjust and unreasonable rates for some. Rather, it was recognizing that removal of this provision would create a long-term benefit to *all* natural gas consumers, including those on systems where short-term difficulties were possible. The Commission concluded that even these customers would be better off in the long term under this Rule than without it. *See supra* at 21-22. Accordingly, the Commission found that

removal of variable costs in minimum commodity bills resulted in just and reasonable rates wherever this step was taken.

VI. Imported Gas Matters

The Rule promulgated in Order No. 380 was applied uniformly to the sales tariffs of all natural gas pipelines within the Commission's jurisdiction. In neither the Notice nor the Final Rule did the Commission distinguish between pipelines whose gas supply is domestic and pipelines whose gas supply (or part thereof) originates outside the borders of the United States. Rather, Order No. 380 addressed concerns of a broad policy nature that apply to all pipelines regardless of the original source of their gas supply.

A number of petitioners sought rehearing, stay, or clarification with respect to the effect of the Rule on pipelines that purchase imported gas, and on non-domestic suppliers upstream of those pipelines. In this regard, several commenters noted the concurring statement by Commissioner Sousa (issued June 4, 1984), wherein he asked that before the Commission issued an order on rehearing, it examine more closely the impact of the Rule on Canadian gas supplies. The following discussion of various rehearing petitions deals with this subject.

Northwest Energy Company (NW Energy):

NW Energy asks that the Commission "clarify whether Order No. 380 applies to minimum bill provisions in Northwest Pipeline's Canadian gas purchase contracts . . . ." (at 1, 7). The answer to this question is no. Order No. 380 can apply only to the tariffs or rate schedules over which the Commission has jurisdiction. It thus applies only to the tariffs or rate schedules under which *jurisdictional pipelines* sell natural gas to their customers.

This Commission has no jurisdiction over the arrangements under which *Canadian* entities sell natural gas to U.S. pipelines.[46] Approval or disapproval of any minimum bill-type provisions contained in these Canadian-domestic agreements is simply not within the Commission's jurisdiction. Accordingly, if a Canadian pipeline has a minimum bill-type provision in the tariff under which it sells gas to a domestic pipeline, that provision remains intact.[47] This Rule clearly cannot and does not apply to the rates charged by entities over which the Commission has no jurisdiction.

NW Energy goes on to state (at 8) that if Order No. 380 does *not* apply to Canadian tariffs or contracts, but *does* apply to NW Pipeline's tariffs (which it does[48]), this would "impose substantial risks on NW Pipeline until such time as Canada implements a market-responsive border pricing policy." Stated another way, NW Energy notes that since its Canadian contracts do contain minimum bill requirements, it "would be obligated to continue to purchase large volumes of high-priced Canadian gas under the existing minimum bill provisions unless they are satisfactorily amended. The failure to meet this obligation would likely result in expensive arbitration or litigation" (at 8). NW

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[46] The Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, transferred to the Secretary of Energy jurisdiction under section 3 of the Natural Gas Act to approve imports and exports of natural gas. With the exception of functions not here relevant, the Secretary of Energy has delegated his section 3 authority to the Administrator of the Department of Energy's Economic Regulatory Administration. (*See* Department of Energy Delegaton Order No. 0204-111, issued February 17, 1984, 49 Fed. Reg. 6684.) Thus, the Administrator has exclusive jurisdiction over the arrangements under which U.S. buyers purchase and import gas from Canadian suppliers.

[47] This also responds to the request by IPAC that the Commission "modify its order . . . to hold that the decision does not apply to minimum bills in Canadian-U.S. contracts . . . ." (at 11.) No such modification is necessary for the reasons explained above.

[48] *But see* discussion *infra* re NW Alaskan Pipeline Company, another affiliate of NW Energy.

Energy contends that under these circumstances the rule should not be applied to NW Pipeline.

The Commission denies rehearing on this point. The circumstances facing NW Pipeline are analogous to those facing many pipelines whose gas supply sources are entirely domestic in nature.[49] These latter pipelines in many cases have take-or-pay contracts with their domestic supply sources that obligate them to purchase large volumes of high-priced *domestic* gas unless they are satisfactorily amended. (*E.g.*, initial comments of Transcontinental Gas Pipe Line Corp. at 3.) The failure to meet these domestic take-or-pay obligations may also result in arbitration or litigation. (*E.g.*, initial comments of Tennessee Gas Pipeline Co. at 6.) To exempt a pipeline from Order No. 380 solely because its supply source is non-domestic would unfairly discriminate among pipelines and tend to perpetuate the very problems which the rule is intended to diminish. (*E.g.*, initial comments of El Paso Natural Gas Co. at 3-5.)

Accordingly, NW Energy has not provided a basis for modification of Order No. 380; its petition for rehearing is denied.

TransCanada Pipelines Limited (TransCanada):

TransCanada, a Canadian entity, sells and transports natural gas to customers in Canada and the United States (including Midwestern Gas Transmission Company (Midwestern)). TransCanada seeks rehearing, expressing concern that Order No. 380 "would prevent the implementation of recently negotiated amendments to [its] contracts with Midwestern . . . ."

TransCanada explains that a recently-negotiated contract amendment between itself and Midwestern (changing take-or-pay and other obligations but not price), and a related agreement with ANR, which buys 85 percent of this gas from Midwestern, "are contingent upon Commission approval of changes

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[49] *See e.g. supra* at 54.

to Midwestern's FERC tariff."[50] The tariff changes (according to Midwestern's petition at 6-7) would bring about lower take-or-pay levels[51] for the near term and a sharing of take-or-pay responsibility among Midwestern's customers.

In essence, the proposed changes to Midwestern's rate schedule (to be made pursuant to this settlement) would lower its minimum commodity bill to ANR from a 75 percent to a 50 percent level for a given period. Midwestern and TransCanada both object to the Rule's effect on their contract amendments. Although neither party specifically states why Order No. 380 would put these potential settlements in jeopardy, the Commission is able to surmise the following. If ANR decides not to purchase this gas, Midwestern cannot, under Order No. 380, force ANR to pay for gas it does not take. Under these circumstances, having the minimum bill level reduced from 75 to 50 percent is of less interest to ANR and of less advantage to Midwestern.[52] If Midwestern is unable to market the gas to ANR, it

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[50] This contract amendment presently awaits ERA approval.

[51] In this regard, TransCanada states (at 8) that Order No. 380 found a lack of direct nexus between take-or-pay and minimum commodity bills. TransCanada notes that in the case of its own contracts with U.S. pipelines, there *is* a direct nexus between its take-or-pay contracts with the pipelines and the pipelines' minimum commodity bills with their customers, because the latter is directly tied to the terms of the former. In response, the Commission notes that TransCanada misunderstands what the Order said. The Commission does not dispute that in many cases there is a nexus between supplier take-or-pay and pipeline minimum commodity bills (Order No. 380 at 9-10). The Commission's discussion of the "nexus" question was in the context of *pipeline customer responsibility* for incurrence of take-or-pay (Order No. 380 at 40-45.) The Commission explained that there was not necessarily a nexus between a pipeline's incurring take-or-pay costs and a particular customer's taking gas at below its minimum bill level.

[52] Midwestern notes that there are numerous other advantages to these amendments in terms of take-or-pay relief, volumes under contract, make-up provisions and length of contract. Indeed, these advantages may be such that ANR will determine that prudent management dictates purchasing this gas as a matter of choice.

may incur take-or-pay obligations to TransCanada, a result about which TransCanada is less than enthusiastic.[53]

This situation once again boils down to a variation on the same theme. Midwestern objects to any rule that would limit its ability to require ANR to buy its gas, and TransCanada objects to any rule that would give Midwestern an incentive to seek further amendments to its contracts with TransCanada. If these objections constituted a basis for not applying the Rule to Midwestern's tariff, however, the same logic would certainly apply to the Rule's potential effect on all contractual obligations (domestic or foreign) between pipelines and their suppliers. The Commission has already rejected this argument.

TransCanada next asserts (at 5-6) that Order No. 380 is contrary to the *New Policy Guidelines and Delegation Orders on the Regulation of Imported Natural Gas,* 49 Fed. Reg. 6684 (1984), issued recently by the Economic Regulatory Administrative (ERA) of the Department of Energy. TransCanada notes that the ERA guidelines "stress the importance of allowing the parties to import contracts the leeway to negotiate solutions to market problems," and asserts (pp. 6-7) that Order No. 380 will "frustrate" the negotiations that have already taken place.[54]

Order No. 380 would not preclude it from so doing. *See* discssion *infra* at 92-94.

[53] It should be emphasized that difficulties in marketing Canadian gas existed long before this Rule was promulgated. Midwestern notes (at 6) that for the contract years ending October 1982 and October 1983, ANR and Midwestern incurred take-or-pay obligations to TransCanada of approximately $73 million and $185 million (Canadian dollars), respectively. Seeking remedies to this problem has been an ongoing activity in the industry for several years now. The same is true of domestic take-or-pay problems. Searches for continuing remedies will go on with or without this Rule.

[54] Along similar lines, Great Lakes' petition (at 17-20) asserts that the impact of the Rule is "effectively to usurp ERA's power to regulate imports of natural gas pursuant to section 3 of the Natural Gas Act," and that the Rule "places at risk the long-standing policy of our country to honor international contracts." In response, the

The Commission does not believe that Order No. 380 is inconsistent with the ERA guidelines.[55] The parties to import contracts remain free to negotiate whatever solutions they believe appropriate to resolving their market problems. What Order No. 380 does is give many pipeline customers the opportunity to purchase lower cost gas supplies without incurring charges for gas they do not take. This opportunity to choose creates market signals between the customer and the pipeline, and then between the pipeline and its supplier(s). Thus, the real effect of Order No. 380 on TransCanada's negotiations with Midwestern and ANR is that these domestic pipelines will need to evaluate what the Order's effect will be on their own markets. This evaluation will establish *one* factor that will bear on these pipelines' current and future negotiations with TransCanada. This factor, like any regulatory restraint or other factor not within the parties' immediate control (*e.g.*, the price of alternative fuels), will have to be considered in reaching agreement. The parties, consistent with the ERA guidelines, will have the leeway to negotiate whatever solutions they believe are appropriate in order to meet the pipelines' markets.

TransCanada characterized (at 5) the efforts of itself and its customers "to modify their contracts in response to changing market conditions" as "successful."[56] If this is the case, there is

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Commission notes that Order No. 380 does not change the terms of any contracts between foreign and domestic companies. *See Supra* at 82-83. Thus, it does not "usurp" ERA's section 3 authority.

[55] ERA concurs with the Commission on this point. *See* letter from Rayburn Hanzlik, Administrator, ERA, to Raymond J. O'Connor, Chairman, FERC, dated July 13, 1984: "From our perspective, the objectives of Order 380 appear consistent with the gas imports policy guidelines issued by the Secretary of Energy last February."

[56] The same sentiment is expressed on the other side of the table as well. A domestic pipeline company, Northwest Energy, notes that it "believes it can successfully achieve [contractual amendments]" with the relevant Canadian entities (Northwest Energy rehearing petition at 8).

every reason to believe that these parties will continue to find ways of successfully coping with genuine market demand.

Finally, TransCanada notes (at 9-10) that "U.S. regulatory authorities were fully aware of TransCanada's sales expectations" when the latter entered into contracts with U.S. pipelines, yet now "it is clear that the Commission expects the new rule to provide pipelines with more leverage to encourage producers to lower prices." Such leverage, argues TransCanada, "is useless against TransCanada because the Canadian government establishes the price at which gas may be exported."

The Commission recognizes that TransCanada must charge whatever price the Canadian government determines is proper for its exported gas. The Commission also notes, however, based on TransCanada's own rehearing petition in this docket, as well as other statements in the record, that the Canadian government — along with Canadian natural gas suppliers — has in fact been responsive to initiatives to alleviate problems associated with purchases of Canadian gas (*e.g.*, rehearing petition of PGT/PG&E at 47). Further, the record is replete with examples of other actions taken in the past year to make Canadian gas more marketable in the United States. Such actions are reflected in the following Commission orders:

a) Northwest Pipeline Corporation, 27 FERC ¶ 61,167 (1984);

b) Great Lakes Gas Transmission Company, 26 FERC ¶ 61,179 (1984);

c) Northwest Alaskan Pipeline Company, 25 FERC ¶ 61,389 (1983);

d) Northern Natural Gas Company, 25 FERC ¶ 61,388 (1983).

Finally, and most significantly, the Commission takes note of the Communique issued by the Canadian Government on July

13, 1984.[57] This document, entitled "New Natural Gas Export Policy to Allow Negotiated Price," explains that as of November 1, 1984, exporters of Canadian natural gas will be "free to negotiate prices with their customers" based on certain criteria set forth in the body of the Communique.

The above-listed actions demonstrate that Canadian entities — producers, pipelines, and the government — are sensitive to the problems faced by domestic pipelines and are indeed willing to work with such pipelines to make Canadian gas prices more responsive to U.S. markets. Accordingly, this argument does not provide a basis for modifying Order No. 380; rehearing on this basis is denied.

Pacific Gas & Electric/Pacific Gas Transmission (PG&E/PGT):

PGT filed a lengthy petition for rehearing. In addition to matters discussed elsewhere in the instant Order, PGT's petition can be distilled to the following.

There are two questions resulting from Order No. 380 about which PGT expresses particular concern (at 5): (1) minimum takes and (2) flow-through of take-or-pay liability. As to the former, Order No. 380 is stayed as discussed *supra* and PGT will have a further opportunity for comment. As to the latter, PGT asks if it will no longer be permitted to flow through take-or-pay charges to PG&E, its affiliate and only customer, but instead will have to finance such take-or-pay itself. In response, the Commission notes that whatever automatic take-or-pay recovery is dictated by PGT's current tariff continues unchanged by this Rule. Thus, as noted in Order No. 380 at footnote 58, PGT maintains an advantage over stated-rate pipelines.

PGT notes (at 31), however, that its cost-of-service tariff provides for PGT to pay the *principal* take-or-pay amount to its

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[57] The Communique is attached to this Order as Appendix C.

Canadian supplier and flow that amount through to PG&E.[58] In turn, PG&E is allowed by the CPUC to recover carrying costs on that amount from its customers. PGT notes that under threse circumstances the following scenario could occur.

When this Rule takes effect, PG&E could decide to purchase less gas from PGT and more gas from other, less expensive, sources. PGT would then incur take-or-pay and PG&E would have to make take-or-pay principal payments to PGT.[59] These payments, when combined with the cost of purchasing gas from a lower cost supply source, would, in the aggregate, cost PG&E *more* than taking PGT's gas to begin with.

Assuming that the costs actually work out this way, there is a clear answer: PG&E should continue to purchase PGT's gas at whatever level is most cost effective. The Commission stresses that the instant rule does not require any customer to stop purchasing gas from any pipeline. The rule simply gives customers more freedom to make choices among potential supply sources. The purchasing decisions then made by customers will,

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[58] This take-or-pay amount is not based on the Canadian border price but on a lesser amount determined by formula.

[59] Again, it should be noted that incurrence of take-or-pay liability would not be a new phenomenon to PGT/PG&E. As stated in a June 12, 1984 letter from Douglas R. Fenton of Alberta and Southern Gas Co. Ltd. (PGT/PG&E's Canadian purchasing agent and affiliate) to the National Energy Board of Canada:

> Unfortunately, in the last few years, it has been necessary to make use of these take-or-pay provisions, because the high price of Canadian gas, combined with the constrained market conditions existing in northern and central California, as in the rest of the United States, has forced PGandE to reduce its purchases below the take-or-pay level and to as low as the minimum contractual take levels, in order to maximize its purchases of lower cost gas from other sources. The resulting take-or-pay liability incurred has been flowed through by Alberta and Southern to PGT, and by PGT to PGandE, under the established take-or-pay provisions of the export/import contract and the PGT/PGandE service agreement and tariff, respectively.

(Attachment to letter submitted by NEB noted *supra* at 2.)

if challenged, have to be judged as to their prudence by the appropriate jurisdictional entity. In the case of PG&E's purchasing decisions, the CPUC will have to make that determination. Factors such as comparative purchased gas costs, otherwise known or projected costs, and adequacy/reliability of long-term supply are the types of factors that a regulatory body might appropriately consider in such a situation.[60] Simply put, this rule does not tell PG&E that it must purchase or not purchase any particular gas supply. It simply gives PG&E more flexibility in its purchasing decisions. PG&E must then decide which gas it *will* take, based upon *all* pertinent considerations.

PGT also alleges (at 8-9 and elsewhere) that Order No. 380 "strayed, without notice, beyond [its] limited and laudable purpose" to eliminate recovery of variable costs not incurred. PGT states that its reading of the Notice of Proposed Rulemaking "was that it would not apply to a pipeline with a cost-of-service tariff, since such tariffs by their nature preclude charging customers for costs not incurred." This issue is fully discussed *supra* with respect to POPCO's petition.

Northwest Alaskan Pipeline Company (NW Alaskan) and Pan-Alberta Gas Ltd./Foothills Pipe Lines (Yukon) Ltd. (Pan-Alberta):

NW Alaskan notes that the Commission specifically stated that Order No. 380 does not apply to the transportation tariffs under which gas is moved through the Alaska Natural Gas Transportation System (ANGTS). It asks that the Commission state, however, whether the Order applies to the revenue stream approved by the Commission in its orders authorizing the construction and operation of the "prebuilt" segments of the ANGTS.

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[60] The CPUC's initial comments indicate, for example, that it requires gas purchases on a least-cost-first basis, "giving consideration to contractual obligations."

This question is echoed by the letter from the National Energy Board of Canada and the petition of Pan-Alberta. These parties point out that the project sponsors of the Canadian segment of the ANGTS, the Canadian producers, and the Canadian lenders and investors relied on the Commission's approval of that stream of revenue in committing themselves to the financing and construction of the "prebuilt" portion of the Canadian segment. They also point out that the government of Canada relied on those Commission orders, as well as on related contemporaneous assurances in the form of a joint resolution by the U.S. Congress and a letter from the President of the U.S. to the Prime Minister of Canada, in approving the early construction of that portion of the ANGTS in Canada.[61]

It is not necessary to parse through the technical language of each of the legal documents cited in Pan-Alberta's petition. The ANGTS is a unique international project whose ultimate success has always rested on a framework of mutual trust and cooperation between the governments of the U.S. and Canada. It is abundantly clear that the assurances made by the Commission, the Congress, and the President collectively comprise a commitment to protect the stream of revenue underpinning the financing of the Canadian segment of the ANGTS, that the Government of Canada relied on those assurances, and that any subsequent action that could adversely affect that stream of revenue would constitute a breach of faith in our nation's relationship with Canada. Accordingly, the Commission confirms that Order No. 380 was not intended to, and does not in fact, apply to the stream of revenue defined in the orders issued by the

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[61] *See* Appendix D to this Order for a more detailed explanation of the unique background of the ANGTS.

Commission[62] authorizing the construction and operation of the "prebuilt" portions of the U.S. segments of the ANGTS.[63]

All that is necessary to accomplish this directive is to clarify that the Rule does not apply to NW Alaskan's sales tariff. NW Alaskan's customers thus will remain subject to the provisions contained in that tariff. This insures both NW Alaskan and its Canadian supplier (Pan-Alberta) collection of the revenue stream as provided by their contracts and tariffs. NW Alaskan's pipeline customers are similarly assured by this Order that they may collect these revenues from their customers via their PGA mechanism (Northern Natural, Panhandle Eastern, United) or their cost-of-service tariff (Pacific Interstate Gas), as provided by their contracts and tariffs.[64]

Trunkline LNG Company (TLC):

TLC's petition covers much of the same ground as other petitions already discussed. In addition, the following is presented.

TLC's facilities were certificated in 1977 to permit importation of liquefied natural gas from Algeria. TLC notes (at 7) that in the certificate order (Opinion No. 796, 58 F.P.C. 726 (1977)) the Commission established a comprehensive minimum bill

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[62] Northwest Alaskan Pipeline Company, *et al.*, Docket No. CP78-123, *et al.*, orders issued January 11, 1980 (10 FERC ¶ 61,032), April 28, 1983 (11 FERC ¶ 61,088), June 13, 1980 (11 FERC ¶ 61,279) and June 20, 1980 (11 FERC ¶ 61,302).

[63] The Commission notes that the level of that stream of revenue has been substantially lowered for the two contract years ending October 31, 1984 pursuant to comprehensive "take-and-pay settlements" between Pan-Alberta and the Canadian producing companies and between Pan-Alberta, Northwest Alaskan, and the U.S. shippers of the "prebuild" gas. (*See* the order on December 15, 1983, 25 FERC ¶ 61,389.) The Commission is also advised that negotiations are now ongoing to deal with the gas marketing problems associated with the Canadian "prebuild" gas for the period after Octob[illegible] 31, 1984.

[64] *See supra* at 31-35.

provision and noted its necessity in financing the project. 58 F.P.C. at 740.

The Commission agrees that TLC's situation is an unusual one. The provision in question established a special minimum bill that would apply under limited circumstances. Those circumstances occur only when TLC is "unable to deliver 100 percent of the gas contracted for by Buyer." Just as exceptional as the circumstances are the *terms* that apply when the minimum bill is invoked. With respect all *other* minimum bills affected by Order No. 380, the Rule acts only to remove variable costs. Thus it does not affect the *fixed* cost recovery that lenders may have relied on and that the Commission may have viewed as necessary to the original financing of the pipeline. In the case of TLC's transatlantic operation, however, the Commission envisioned circumstances where the company might have to pay the LNG supplier or the shipping costs even where it is unable to deliver the LNG to its customer, thereby jeopardizing debt service for the project. Thus in TLC's minimum bill, the Commission listed the amounts paid to the LNG supplier and transoceanic shipping costs as *"fixed"* costs:

> In the event that Seller [TLC] is unable to deliver 100 percent of the gas contracted for by Buyer [TLC customer] during any period exceeding one day, Buyer shall reimburse Seller not only for volumes delivered, but also for contract volumes not delivered, such that *Seller will recover* on the non-delivered volumes an apportioned share of Seller's *nonequity-related fixed expenses* incurred during such period, *limited to the following:*
>
> (a) Operating and maintenance expenses;
>
> (b) Taxes payable;
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> (c) Interest expense based on that portion of Seller's then existing debt which was incurred for the construction of the LNG and related facilities;
>
> (d) The requirements for repayment of such debt; and

(e) Amounts, if any, Seller shall be obligated to pay suppliers arising from Buyer's failure to accept deliveries from Seller.[65]

58 F.P.C. at 740. (Emphasis added.)

In TLC's case the Rule would actually remove "fixed" costs from TLC's minimum bill. Removal of *fixed* cost recovery is something the Commission did not intend in promulgating the Rule. *See* Order No. 380 at page 55.

Accordingly, the Commission concludes that application of the Rule to TLC's minimum bill would be inconsistent with the intent of Order No. 380. Therefore the Commission will waive the provisions of § 154.111 as they would otherwise affect TLC's minimum bill.[66] In all other respects TLC's petition for rehearing is denied.

VII. Motions for Stay

As discussed *supra,* application of the Rule to minimum take provisions will be stayed by this Order.

A number of petitioners also sought a stay of the remaining aspects of Order No. 380. It is normally the Commission's practice simply to deny stay requests on the basis of "the need for definitiveness and finality in administrative proceedings." *Arkansas Louisiana Gas Co.* 23 FERC ¶ 61,324 at 61,714

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[65] On rehearing, (e) was revised to read: *"Amounts, if any, Seller shall be obligated to pay for LNG supplies and for ocean transportation under the LNG supply and shipping contract."* 58 F.P.C. at 2944. (Emphasis added.)

[66] TLC's certificate of public convenience and necessity for the project, the provisions of its tariff, and the prudence of the LNG purchases are under review and consideration in a number of Commission proceedings. *See* Trunkline LNG Company, Docket No. RP81-85-000, 16 FERC ¶ 61,102; Trunkline LNG Company, Docket No. CP74-138-003, 22 FERC ¶ 61,245; Trunkline LNG Company, Docket No. CP74-138-010, 24 FERC ¶ 61,077; Trunkline Gas Company, Docket No. TA83-1-30-002, 26 FERC ¶ 61,363. Nothing said here shall affect in any way the decisions made in those other cases.

(1983). In this case, however, due to the importance the Commission attaches to Order No. 380 and the number of stay petitions filed, the Commission believes it is appropriate here to discuss briefly the substantive reasons that stay is denied. Accordingly, the Commission will consider the factors that a court would weigh in deciding whether to stay agency action pending the outcome of an appeal. These factors are: (1) Has the petitioner made a substantial case on the merits? (2) Has the petitioner shown that it will be irreparably injured without a stay? (3) Would a stay injure other parties to the proceeding? (4) Where does the public interest lie? *Washington Metropolitan Area Transit Commission* v. *Holiday Tours, Inc.*, 559 F.2d 841, 843 (D.C. Cir. 1977).

The petitioners' merits arguments are several: that the Commission is without authority to act in this fashion by rulemaking rather than case-by-case adjudication; that the Commission has unlawfully altered a provision of a certificate of public convenience and necessity outside a section 7 hearing; that the Commission's factual basis is not supported by substantial evidence; that the Commission is acting arbitrarily and capriciously as to individual cases. Order No. 380 and the instant Order deal adequately with the merits of these contentions. For reasons already stated there, the Commission finds petitioners' arguments do not warrant a stay.

As to irreparable injury, the Commission notes that a number of pipelines have been operating for years without minimum commodity bills. As for pipelines that would be affected by the Rule, the Commission emphasizes that Order No. 380 does not alter pipelines' recovery of their fixed costs. It is true, however, that those pipelines selling high priced supplies may lose some sales as purchasers seek more economic supplies. Thus enhanced competition could hurt less competitive sellers.

Some pipelines allege injury in that they will incur take-or-pay payments with producers if their sales decrease. But as

Order 380 and the instant Order explain, pipelines do not incur these costs immediately, and they have many options as to how to handle them if actually incurred. (As one option, pipelines can seek to recover such costs by filing a rate case with the Commission.) Thus pipelines will not be irreparably injured by Order No. 380.

In any event, a stay would leave in place tariff provisions the Commission has found unjust and unreasonable because they (1) permit potential collection of "costs" not incurred and (2) compel customers to purchase high-priced gas even though lower-priced gas may be available from other sources. Thus a stay would simply perpetuate the unjust, unreasonable, and anticompetitive results of existing minimum commodity bills.

Avoiding any potential injury to certain pipelines would necessarily be at the expense of the customers who are now restrained by existing minimum bills from switching to lower-priced supplies. But more importantly, a stay would be at the expense of the consuming public. As the Commission explained, existing minimum commodity bills create artificial demand for high-priced gas, resulting in inaccurate signals upstream to producers. They also artificially protect pipelines from a measure of competition. The sooner these artifical impacts on the marketplace are removed, the sooner competition will begin to have its market-ordering impact on natural gas prices. By contrast, a stay will continue to force consumers to purchase gas at artificially propped-up prices.

Accordingly, it is clear that a stay would injure other parties and would not be in the public interest. Upon due consideration, then, the Commission hereby denies stay of Order No. 380.

VIII. Late-Filed Pleading

On July 20, 1984, Distrigas Corporation and Distrigas of Massachusetts Corporation filed for Reconsideration and Stay of Order No. 380, or, in the alternative, for Waiver. Given the

extreme lateness of this pleading, the Commission declines to consider its merits in the context of this order. It will be redocketed and treated as a motion for waiver; it is otherwise denied.

IX. THE COMMISSION ORDERS:

1. Order No. 380 is clarified to stipulate that it does not apply to the stream of revenue approved by the Commission in authorizing the ANGTS prebuild.
2. Order No. 380 is stayed with respect to minimum physical take provisions in pipeline rate schedules or tariffs until November 1, 1984. All other requests for stay or for oral argument are denied.
3. Section 154.111 of the Commission's regulations is waived, to the extent set forth in the body of this Order, with respect to Trunkline LNG Company.
4. All other petitions for rehearing are denied for the reasons set forth in the body of this Order.

By the Commission.

(S E A L)

KENNETH F. PLUMB
Kenneth F. Plumb
Secretary

APPENDIX A
Timely Petitions for Rehearing, Clarification, and/or Stay

Arkansas Louisiana Gas Company (001)*

Great Lakes Gas Transmission Company (002)

Certain Distribution Company Customers of Northwest Pipeline Corporation (003)

Kentucky West Virginia Gas Company (004)

Wisconsin Distributors Group (005)

Southern California Gas Company/Pacific Lighting Gas Supply Company (006)

Pacific Interstate Offshore Company (007)

Texas Eastern Transmission Corporation (008) (also seeking oral argument)

Pacific Offshore Pipeline Company (009)

Algonquin Gas Transmission Company (010)

Pacific Gas Transmission Company/Pacific Gas & Electric Company (011) (028)

Public Utilities Commission of State of California (012)

Texas Gas Transmission Corporation (012)

Pan-Alberta Gas Ltd./Foothills Pipe Lines (Yukon) Ltd. (013) (027)

M.I.G.C., Inc. (014)

Transwestern Pipeline Company (015) (also seeking oral argument)

Northwest Energy Company (016) (028)

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* Number in parentheses indicates sub-docket number assigned to pleading.

Northwest Alaskan Pipeline Company (017) (029)

Trunkline LNG Company (018)

Tennessee Gas Pipeline Company (019)

ANR Pipeline Company (020) (030)

TransCanada Pipelines Ltd. (021)

Midwestern Gas Transmission Company/East Tennessee Natural Gas Company (022)

Transcontinental Gas Pipe Line Corporation (023)

Panhandle Eastern Pipe Line Company/Trunkline Gas Company (024)

APPENDIX B

Examples of ways in which pipelines are negotiating take-or-pay liability:

1. Northern Natural Gas Co., Docket No. RP82-71-002, 23 FERC ¶ 61,198 (1983)

   (Order approving settlement involving one-time payment of 20 percent in lieu of take-or-pay liabilities.)

2. Natural Gas Pipeline Co. of America; Docket No. CP81-302. Transcript of hearing at 47-48.

   (Company witness testified that Natural had paid $52 million in take-or-pay but had avoided $200 million through contract negotiation.)

3. Panhandle Eastern Corp. (Panhandle & Trunkline), Presentation to New York Society of Security Analysts, June 27, 1984, remarks by Robert D. Hunsucker, President and C.E.O. (relevant page attached).

   ("As of today, we have signed or reached substantive conclusion on more than 100 take-or-pay relief agreements with domestic producers on both pipeline systems. In the aggregate, these agreements have reduced the take-or-pay exposure by $360 Million. Settlement payments related to these agreements total $30 million.")

4. United Gas Pipe Line Co., RP81-81-000, *et al.*, Transcript of hearing at 415, 427, 463-64.

   (Company witness testified that United had negotiated a complete waiver of its 1982 take-or-pay liability under certain contracts and reduced its liability to a 50 percent level in others.)

Take-or-Pay Relief

As of today, we have signed or reached substantive conclusion on more than 100 take-or-pay relief agreements with domestic producers on both pipeline systems. In the aggregate, these agreements have reduced the take-or-pay exposure by $360 Million. Settlement payments related to these agreements total $30 Million.

Let me point out a few aspects of the strategy involved in our discussions with producers. Of importance is the fact that thus far, we have preserved virtually all of the gas reserves covered by renegotiated contracts for future use. Secondly, we are enhancing operating flexibility so as to purchase at the lowest average cost mix of NGPA price categories while recognizing drainage and state proration limitations. And thirdly, we are establishing the basis for settling the take-or-pay exposure which will accrue in 1984.

Moving apace with the adjustments to supply have been our efforts to create special selling tools that pass regulatory muster — no easy task. However, we now have two such programs in operation: PanMark Gas Company and the MAT program.

PanMark, which required 11 months to traverse the regulatory process, began operating early this month. PanMark is moving connected production, which provides take-or-pay credits, to 19 end users through our utility customers. The volume this month appears to be approximately 400 million cubic feet. The net-back wellhead price ranges between $2.90 and $3.21 per million Btu.

APPENDIX C

NEW NATURAL GAS EXPORT POLICY TO ALLOW NEGOTIATED PRICE

CALGARY — Exporters of Canadian natural gas will be free to negotiate prices with their customers for implementation as early as November 1, the Honourable Gerald Regan, Minister of Energy, Mines and Resources, announced today. Under the new policy, exporters can hold to the existing two-tiered administered price, or they can negotiate a price that will be subject to review by the National Energy Board (NEB), based on established criteria, and to subsequent approval by the Government of Canada.

"The new policy should stabilize gas export sales in the short term," said Mr. Regan. "It will provide increased sales opportunities over the medium term and long term. We expect that this policy will enhance cash flow to producers, promote activity by the natural gas industry, create jobs for Canadians and foreign exchange support for the Canadian dollar, and generate revenues to producing provinces and the Government of Canada. In addition, proponents of new export projects, such as Venture, will know the rules that apply for future Canadian exports."

Canada has a longstanding policy of allowing the export of natural gas that is surplus to foreseeable Canadian needs. In recent years sales have been eroded by changes in United States markets and by increasing competition in the specific areas served by Canadian gas. Under the new policy, exporters will have the flexibility to meet the competitive challenge in specific markets.

"The work done by a task force of officials from the Government of Canada, the Government of Alberta and the Government of British Columbia has greatly assisted the federal government in formulating this policy," Mr. Regan said. The task force worked in close consultation with gas exporters and the producing industry.

The NEB review process will require exporters to show that negotiated contractual arrangements will enhance the economic return to Canada, compared with the current system, and are in Canada's national interest. Another important condition is that the price of exported gas will not be less than the price paid by Canadians.

The Minister added: "These new export rules combine with a number of measures in the domestic market that the federal government has taken in recent years to enhance natural gas sales. Expansion of gas distribution networks in eastern Canada, incentive measures to promote sales in the industrial sector, and off-oil programs that encourage substitution of oil by other fuels, inculding gas, are some examples of these measures.

"Under the terms of the Government of Canada's pricing agreement with Alberta, domestic gas prices have been stable for nearly two years. The recently announced industrial incentive plan demonstrates the government's concern about pricing flexibility in the domestic as well as the export market. We will be prepared to address with Alberta, in the context of future discussions, options for a more market-responsive domestic natural gas pricing regime than that which currently exists."

For further information, please contact:

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BACKGROUNDER
A NEW CANADIAN NATURAL GAS EXPORT PRICING POLICY

Importance of Natural Gas Exports

Natural gas is one of Canada's great energy strengths: as a substitute for expensive and insecure oil, as a major source of export earnings, and as an important contributor to economic activity, particularly in the West. Continued exploration success has led to a growing surplus of natural gas. However, having spent considerable time, effort and money on gas exploration and development, many companies are constrained, by limited markets, from realizing a return on their investment. The problem is particularly serious for many of the industry's smaller firms.

Canada has recognized the success of the gas industry in finding new reserves by authorizing the export of increased volumes to the United States and new exports to Japan. Total licensed volumes available for export to those countries is approximately 505 billion cubic metres (10^9m^3) (17.8 trillion cubic feet (TCF)), and 63 x 10^9m^3 (2.2 TCF), respectively.

Despite these increased authorizations, some of which are pending import approval from US regulatory bodies, Canadian exports have declined over the past several years.

In 1983 volumes totalling 20.21 x 10^9m^3 (713 BCF), representing 30 per cent of total Canadian gas production and 43 per cent of maximum annual export authorizations, were exported to the United States, resulting in related export earnings of approximately $Cdn 3.9 billion. These export revenues, net of transmission, gathering and operating costs, are shared between the producing industry, the provinces of Alberta and British Columbia, and the Government of Canada. Natural gas export sales in 1983 provided approximately 15 per cent of total

revenues accruing to the upstream operation of the petroleum industry.

With more than sufficient reserves to meet currently projected future Canadian requirements and authorized exports, an appropriate natural gas export policy will allow Canada to increase the level of gas trade with the United States substantially as markets strengthen over time.

History of Gas Export Pricing

Before 1975 the price at which Canadian natural gas was exported to the United States was determined by contract negotiation between the purchasing and selling companies, subject to Canadian approvals from the National Energy Board (NEB) and the Governor-in-Council, and US approvals from the Federal Power Commission. The US natural gas industry was subject to extensive regulation, resulting in burner-tip gas prices below those of competing fuels. The price differential between natural gas and competing oil was further accentuated by the rapid escalation of crude oil prices during the 1973-74 period.

In 1974 the NEB became concerned that the export sales price of Canadian natural gas under existing licences did not reflect the changes in the US energy market. It recommended an increase in the selling price of Canadian gas exports from the prevailing 55 cents (US) per million British thermal units (MMBtu) to $US 1.00/MMBtu effective January 1, 1975 (for sales from British Columbia, effective November 1, 1974).

Further increases in export prices were recommended in subsequent reports. In 1976 the NEB recommended a range of export prices based on commodity value in the various markets served. However, the United States opposed the idea of differential pricing implicit in the commodity value pricing mechanism, on the grounds that differential pricing represented an extension of Canadian jurisdiction beyond the International Boundary and that it was discriminatory among US distirbutors. Thus, at the

request of the United States Government, Canada retained the single border price.

In 1977 the NEB introduced the concept of "substitution value". Under this system, the value of Canadian gas exports was tied directly to the cost of Canadian oil imports. Canadian gas sold for export could be used to back out imported oil and its value should therefore be determined by oil import costs.

In March 1980 Canada and the United States reached an Understanding on natural gas export pricing. It consisted of an exchange of letters between the then US Secretary of Energy, Charles W. Duncan, and the Canadian Minister of Energy, the Honourable Marc Lalonde. This Understanding, commonly called the Duncan-Lalonde formula, endorsed and formalized the substitution value concept. The only price increase that took effect under the Duncan-Lalonde formula was on April 1, 1981.

As a result of amendments that were made to the National Energy Board Act during 1982, the responsibility for establishing gas export prices rests directly with the Governor-in-Council. On April 11, 1983 the government reduced the export price from $US 4.60 per gigajoule (GJ) ($US 4.94/MMBtu to $US 4.10/GJ ($US 4.40/MMBtu) to track a decline in Canadian crude oil import costs.

In July 1983, in an effort to preserve our share of a shrinking US natural gas market, a volume-related incentive price (VRIP) of $US 3.17/GJ ($US 3.40/MMBtu) was prescribed for incremental sales above a base volume generally equal to 50 per cent of annual licensed quantities. The price of base volumes continued to be related to the oil substitution value. Effective November 1, 1983, flexibility was added to the VRIP scheme by allowing exporters to make some portion of sales at the incentive price each month.

Federal — Provincial Task Force

The federal government became concerned about the appropriateness of Canada's gas export pricing policy in light of the changes in the US natural gas market. It initiated a task force of representatives from the governments of Canada, Alberta and British Columbia to review this policy. The specific mandate of the task force was to generate, analyze and review with industry a range of export pricing options. The task force had several discussions with the two producer associations (the Canadian Petroleum Association and the Independent Petroleum Association of Canada) and with each of the gas exporting companies.

New Export Pricing Policy

Effective November 1, 1984 the price for natural gas exports at the Canada-United States Boundary will be determined by one of two approaches:

1. A contract price will be negotiated between the Canadian exporter and the US importer, approved by the appropriate regulatory authorities. Where this negotiated price replaces the current government-administered price, the exporter must demonstrate that the negotiated price, in combination with other contract provisions, will provide an enhanced economic return to Canada compared with 2 (below).

2. Until a contract as described above is negotiated and approved, the export price will be determined under the provisions of the VRIP program. For 1984-85, the base price will be $US 4.40/MMBtu, the incentive price will be $US 3.40/MMBtu, and the threshold level will be the lesser of 50 per cent of annual licence quantity or 1981-82 actual sales.

Criteria for Acceptability

To obtain approval, all licence holders must demonstrate that their negotiated contractual arrangements meet the following criteria:

1. The price of exported natural gas must recover its appropriate share of the costs incurred.
2. The price of exported gas must not be less than the wholesale price of natural gas at the Toronto city gate and sold under similar terms and conditions.
3. The price of exported gas must result in prices, in the United States market area, at least equal to the price of major competing energy sources.
4. Export contracts must contain provisions which permit adjustments to reflect changing market conditions over the life of the contract.
5. Exporters must demonstrate that export arrangements provide reasonable assurance that volumes contracted will be taken.
6. Exporters must demonstrate that producers supplying gas for an export project endorse the terms of the export arrangement and any subsequent revisions thereof.
7. Exporters must demonstrate that, where existing contracts are renegotiated, the economic return to Canada will be enhanced.

The "Prebuild" Situation

A special situation exists with the "Prebuild" pipeline system that was constructed to carry Alaskan natural gas to markets in the lower 48 states. The United States has consistently acknowledged its commitments to Canada regarding this system, recognizing that it is unique relative to other pipelines.

Canadian regulatory authorities have taken several initiatives to minimize the unit cost of transportation on the Canadian portion of the Prebuild. The high capital cost, low throughput and a short amortization period have resulted in abnormally high transportation costs on the US portion.

In these circumstances it would be expected that export pricing arrangements for natural gas exported through this system would not be based on a "netback" pricing approach but would be structured to ensure a fair and equitable price at the Canada-United States border.

Spot Sales

A market is growing in the United States for spot or short-term direct sales. Under the new policy Canadian exporters may seek to participate in this market.

Arrangements for short-term or spot sales must meet the applicable general criteria. In addition, proponents of proposed spot sales would have to demonstrate that

(i) the sales are truly incremental and will not displace other Canadian gas sales, directly or indirectly; and

(ii) the sales are on an interruptible or best efforts basis to ensure that longer term export sales and capacity to meet Canadian requirements are not pre-empted.

Regulatory Review and Government Approval

The National Energy Board will be responsible for determining (and making subsequent recommendations to the Governor-in-Council) whether negotiated export arrangements meet the standard of public interest as set out in the criteria for acceptability. This approach was advocated by the task force on the advice of industry.

Applicants may submit export contractual arrangements for regulatory review and subsequent government approval as these arrangements are completed. The date on which the negotiated

price becomes effective will be the later of the date of Governor-in-Council approval or the date specified in the negotiated contract.

The NEB will monitor export arrangements to ensure continued compliance with the criteria for acceptability, and will report annually on its findings to the Minister of Energy, Mines and Resources Canada.

Although the NEB has exclusive authority to issue short-term orders, the price of gas exported under such orders will still require Governor-in-Council approval.

Implementation

Exporters who renegotiate contracts must demonstrate the superiority of the negotiated arrangements to the existing government-administered pricing system. This approach will require the comparison of two revenue forecasts, that which would occur under the VRIP program and that which will occur under the negotiated contract.

Several specific contract features could support the claim that the negotiated contract is beneficial:

(i) terms ensuring that Canadian export volumes receive equitable base volume treatment, appropriately recognizing the reserve-based nature of Canadian contracts;

(ii) pricing terms or mechanisms that provide an incentive for the United States buyer to maximize takes of Canadian natural gas, such as demand-commodity pricing;

(iii) take-or-pay clauses.

These are only examples of potential contract clauses suggested by the task force. The onus must be on the exporter to demonstrate the merit of accepting a change from the current VRIP system. Given the variety of market circumstances that

exist, it is not appropriate to be overly precise on the specific contract terms required.

Incentives

Natural gas trade takes place within a long-established framework of policies and institutions, at both the federal and provincial levels. There may be cases where, because of these factors, natural gas producers and exporters are shielded from the full effects of market forces. In future, industry should have the proper incentives to negotiate the best contracts and to pursue the best markets. The federal government is interested in consulting the provinces and the natural gas industry to identify and resolve any problems that may inhibit the effectiveness of buyer-seller negotiations or that may reduce the economic benefits which should flow to Canada from export trade.

APPENDIX D

The Alaska Natural Gas Transportation System (ANGTS) is an international project designed to transport natural gas from the North Slope of Alaska, through Canada, to the contiguous-48 states of the United States. The ANGTS is unlike any other gas pipeline system in the United States because it is governed by a unique legal framework. Pursuant to the Alaska Natural Gas Transportation Act (ANGTA),[1] President Carter submitted his *Decision and Report to Congress on the Alaska Natural Gas Transportation System,*[2] which Congress approved by Joint Resolution;[3] it designated the route for the ANGTS and the U.S. project sponsors.[4] Pursuant to ANGTA, in 1981 President Reagan submitted his *Findings and Proposed Waiver of Law,*[5] which Congress approved by Joint Resolution.[6]

The ANGTS is also governed by two international agreements with Canada, both of which have the force and effect of law in the United States.[7] Finally, Reorganization Plan No. 1 of 1979,

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[1] 15 U.S.C. §§ 719-719o. In enacting ANGTA, Congress found that, because of the large reserves of natural gas in Alaska, expeditious construction of a viable natural gas transportation system for delivery of Alaska natural gas to United States markets would be in the national interest. See 15 U.S.C. § 719.

[2] Executive Office of the President, Energy Policy and Planning (September 1977).

[3] H.R.J. Res. 621, Pub. L. 95-158, 91 Stat. 1268 (1977).

[4] The Northern Pipeline Act of 1978, 26-27 Eliz. II, c.20, designated the project sponsors for the Canadian segments of the ANGTS.

[5] *Reprinted in* H.R. Rep. No. 350, 97th Cong., 1st Sess. 25 (1981).

[6] S.J. Res. 115, Pub. L. 97-93, 95 Stat. 1204 (1981). The President proposed the *Waiver* to "clear away governmental obstacles to proceeding with private financing of this important project." Message from the President Accompanying Findings and Proposed Waiver of Law, *reprinted in* H.R. Rep. No. 350 (part 2), 97th Cong., 1st Sess. 30 (1981).

[7] The "Agreement Between the Government of the United States of America and the Government of Canada Concerning Transit Pipelines," 28 U.S.T. 7449, T.I.A.S. No. 8720, entered in force October

which was submitted by the President to the Congress and not disapproved by the Congress, establishes the Office of the Federal Inspector, which is responsible for monitoring the construction of the ANGTS and for coordinating the issuance of permits and certificates for the ANGTS by all Federal agencies. The uniqueness of the ANGTS legal framework, as outlined above, has been confirmed in a series of court decisions.[8]

Although the financing and construction of the northern portions of the ANGTS have encountered protracted delays, the above-described legal mandate for the ANGTS has not been in any way altered or repealed; it remains binding on the Commission. That unique legal mandate clearly authorizes — indeed, virtually requires — *sui generis* treatment of the revenues supporting the financing and construction of the "prebuilt" Canadian segment of the ANGTS.

Early construction ("prebuilding") of the lower portion of the ANGTS was foreshadowed in the *Report* accompanying the President's *Decision*.[9] The Commission issued certificates authorizing the construction and operation of the "prebuild" Western Leg and Eastern Leg segments in a series of four orders

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1, 1977 after ratification by the Senate, applies to, and mandates nondiscriminatory treatment of, all pipelines in both countries whenever one country's pipelines carry the other country's gas or oil. The "Agreements Between the United States of America and Canada on Principles Applicable to a Northern Natural Gas Pipeline," signed by representatives of the two governments on September 20, 1977, is an executive agreement that was made part of the President's *Decision* and thereby has the legal status of a statute; it specifies the route of the ANGTS and contains numerous conditions.

[8] *See Midwestern Gas Transmission Co.* v. *FERC*, 589 F.2d 603 (D.C. Cir. 1978); *Earth Resources Co.* v. *FERC*, 617 F.2d 775 (D.C. Cir. 1980); *FERC* v. *Public Service Commission of North Dakota*, 513 F. Supp. 653 (D.N.D. 1981); and *Metzenbaum* v. *FERC*, 675 F.2d 1282 (D.C. Cir. 1982).

[9] Report at xii.

issued in 1980.[10] In that proceeding, an issue arose with respect to authorization of "take-and-pay" obligations in the import contracts (a matter then within the Commission's jurisdiction). Ultimately, the Commission established a dollar "cap" on the total "take-and-pay" obligation, and attached it as a condition to the Commission's authorizations. The "cap", defined in a formula that permits adjustments for inflation, revises the volume of gas required to be taken commensurately and inversely with changes in the price of the gas, such that the maximum "take-and-pay" obligation, when measured in dollars (as adjusted for inflation), remains constant. In adopting the "cap", however, the Commission explicitly recognized the necessity and importance of assuring a minimum stream of revenue to support the financing of the ANGTS and ANGTS-related production and pipeline facilities in Canada.

Following certification of the U.S. "prebuild" segments, the focus shifted to Canada. The Canadian segment was designed to accommodate the anticipated substantial volumes of gas from Alaska. Before authorizing the construction of the "prebuild" segment in Canada, the Government of Canada sought certain assurances from the Government of the U.S. with respect to the financing and construction of the complete ANGTS. Those assurances were provided in the form of a Joint Resolution of Congress[11] and a letter from President Carter to Prime Minister Trudeau.[12] Thereafter, the Government of Canada approved the construction of its part of the overall ANGTS "prebuild" project.

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[10] *See supra* at n.10.

[11] S. Con. Res. 104, 96th Cong., 2d Sess. (1980).

[12] July 18, 1980.

APPENDIX F

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PIPELINE RATES: REHEARING

Before Commissioners: Raymond J. O'Connor, Chairman; A. G. Sousa, Oliver G. Richard III and Charles G. Stalon.

Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions	Docket Nos. RM83-71-032, RM83-71-033, and RM83-71-034

ORDER NO. 380-B
ORDER DENYING REHEARING AND GRANTING CLARIFICATION

(Issued October 24, 1984)

On May 25, 1984, the Federal Energy Regulatory Commission (Commission) issued Order No. 380,[1] a final rule requiring elimination from natural gas pipeline tariffs of any minimum commodity bill provisions that operate to recover variable costs. On July 30, 1984, the Commission issued Order No. 380-A[2] denying rehearing in part and clarifying the rule in part. Transwestern Pipeline Company (Transwestern) and Indiana Gas Company, Inc. (Indiana Gas) filed timely petitions for rehearing of Order No. 380-A.[3] On August 24, 1984, Pacific Offshore Pipeline Company (POPCO) petitioned the Commission to

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[1] Docket No. RM83-71-000 (issued May 25, 1984), 49 Fed. Reg. 22,778, (June 1, 1984), FERC Stat. & Reg. ¶ 30,571 (hereinafter cited as Order No. 380).

[2] Docket No. RM83-71-000 (issued July 30, 1984), 49 Fed. Reg. 31,259 (August 6, 1984), FERC Stat. & Reg. ¶ 30,584 (hereinafter cited as Order No. 380-A).

[3] An Order Granting Rehearing Solely for the Purpose of Further Consideration was issued on September 28, 1984. 49 Fed. Reg. 39,042 (October 3, 1984).

clarify Order 380-A and issue a declaratory order with respect to the effect of the rule on POPCO's tariff. The issues raised in these three petitions are discussed below. The Commission is also issuing today a companion Order No. 380-C which, among other things, reaffirms the applicability of the rule to minimum physical take provisions in pipeline rate schedules or tariffs.

Indiana Gas

In Order No. 380-A, the Commission noted that the cost a downstream pipeline pays an upstream pipeline for gas is a "purchased gas cost" regardless of what types of costs make up the total charge for the gas. As a "purchased gas cost" the entire amount paid for the gas by the downstream pipeline is considered variable and recovered through the purchasing pipeline's commodity charge.[4] Indiana Gas notes that the fixed costs incurred by a downstream pipeline in payment of an upstream pipeline's minimum commodity bill will be recovered via the PGA mechanism designed to recover variable purchased gas costs. Indiana Gas asserts that partial requirements customers could evade their fixed cost responsibility simply by discontinuing their gas purchases. These customers would then not be billed for purchased gas costs and would avoid paying for the embedded costs discussed above. Indiana Gas alleges that such costs will be shifted to the full requirements customers.

In Order Nos. 380 and 380-A, the Commission addressed this issue in the context of treatment of the take-or-pay payments, and decided to refrain from imposing any methodology for assigning cost responsibility for take-or-pay costs. The Commission notes that the issue of cost shifting may be raised in a section 4 rate case or a semi-annual PGA adjustment case filed by a downstream pipeline. In those proceedings, the Commission can determine whether a partial requirements customer should be responsible for shouldering some of the cost burden incurred

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[4] Order No. 380-A, FERC Stat. & Reg. at 31,042.

by a downstream pipeline with respect to its minimum commodity bill payments to an upstream pipeline and if there are other countervailing considerations. Accordingly, Indiana's request for rehearing is denied.

Transwestern

The Commission clarified, in Order No. 380-A, that the rule does not apply to the revenue stream approved by the Commission in its orders authorizing the construction and operation of the "prebuilt" segments of the ANGTS.[5] Transwestern argues that interstate pipelines receiving gas through the "prebuilt" portion of the Canadian segment of the ANGTS should be subject to the rule. In particular, Transwestern argues that a competitor, PITCO, which purchases gas from the "prebuilt" segment, has been granted an undue preference and advantage which unlawfully discriminates against Transwestern. The company also argues that the Commission failed to adequately explain its decision based on substantial record evidence.

The Commission is unpersuaded that the exemption granted to the "prebuilt" segments of the ANGTS should be rescinded because those segments are treated differently from other pipelines. As explained in Order No. 380-A and Appendix D to that order, the ANGTS is a unique international project governed by a unique legal framework which has been upheld by the courts. The Commission's decision to exempt the pre-built segments of the ANGTS is consistent with its past actions recognizing that uniqueness. Moreover, as further explained in Order No. 380-A, the exemption is based on the Commission's repeated assurances of a stream of revenues for the construction and operation of the "pre-built" segments of the ANGTS.[6] Those assurances, in turn, reflect the mutual trust and cooperation between the governments of the U.S. and Canada with respect to the ANGTS.

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[5] *Id.* at 31,061-62.

[6] *Id.* at 31,062, 31,067 note 62.

Therefore, the Commission may not and will not subject PITCO to the rule, as requested by Transwestern. Accordingly, Transwestern's request for rehearing is denied.

Transwestern further argues that the Commission failed to analyze Transwestern's tariff "while relying on tariffs and contracts in exempting other interstate pipelines from Order Nos. 380 and 380-A." Transwestern argues that the Commission failed to consider Transwestern's take-or-pay exposure and placed Transwestern at undue risk in recovering its costs.

The Commission in Order No. 380-A found that Transwestern had presented no factual situation that would justify reaching a different result.[7] To the extent that Transwestern can demonstrate unique circumstances on its system, Transwestern can file a request for waiver of the rule to its tariffs. Since the rule was designed to encourage competition, a showing of temporary competitive disadvantage without any other particular circumstances is insufficient for waiver. If Transwestern can demonstrate other compelling circumstances showing why it should not be subject to the rule, the Commission will consider such a request in a separate proceeding, as described in Order No. 380.[8]

POPCO

POPCO seeks clarification that the Commission's treatment in Order No. 380-A regarding Pacific Gas Transmission's (PGT) cost-of-service tariff should also be granted to it. POPCO asserts that its cost-of-service tariff is identical to PGT's cost-of-service tariff, which, as noted in Order No. 380-A, provides for PGT to pay the principal amount of its take-or-pay payment to its supplier and flow that amount through to its sole customer. The Commission stated that "whatever automatic take-or-pay

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[7] *Id.* at 31,049.

[8] Order No. 380, FERC Stat. & Reg. at 30,973.

recovery is dictated by PGT's current tariff continues unchanged by this Rule."[9] POPCO asserts that its flow through provision, like that of PGT, remains valid and operative after the effective date of Order Nos. 380 and 380-A.

The Commission has examined the subject provision of POPCO's tariff and agrees that its provision is nearly identical to PGT's take-or-pay tariff provision. Both tariff provisions provide that the customer will pay for volumes of gas paid for but not taken by the pipeline. In Order No. 380-A, the Commission noted that a cost-of-service tariff provision providing for the automatic recovery of principal amounts of take-or-pay payments would not be invalidated by this Rule.[10] Thus, the Commission will grant POPCO's request by clarifying that the above-mentioned provision of its tariff remains valid after the effective date of the rule.

By the Commission.

(SEAL)

KENNETH F. PLUMB
Kenneth F. Plumb,
Secretary.

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[9] Order No. 380-A, FERC Stat. & Reg. at 31,061.

[10] *Id.*

APPENDIX G

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Raymond J. O'Connor, Chairman; A. G. Sousa, Oliver G. Richard III, and Charles G. Stalon.

Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions } Docket No. RM83-71-001 through 030

ORDER NO. 380-C
ORDER ON REHEARING REAFFIRMING APPLICATION OF RULE TO MINIMUM TAKE PROVISIONS AND DENYING REQUESTS FOR WAIVER

(Issued October 24, 1984)

I. INTRODUCTION

The Federal Energy Regulatory Commission (Commission) is: (1) reaffirming the application of the rule, as promulgated, to minimum physical take provisions in pipeline rate schedules or tariffs; (2) denying requests for waiver filed by Arkansas Louisiana Gas Transmission Company, and Pacific Gas Transmission Company; and (3) directing MIGC, Inc., to file an Interim Agreement, dated December 20, 1983, as part of its FERC Gas Tariff.[1]

II. BACKGROUND

On June 1, 1984, the Commission issued Order No. 380[2] which requires elimination from natural gas pipeline tariffs those

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[1] The Commission issued, also on this date, companion Order No. 380-B.

[2] Order No. 380, Docket No. RM83-71-000, Final Rule, *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, 27 FERC ¶ 61,318 (1984),

provisions that operate to recover variable gas costs for gas not taken by the buyer. On July 30, 1984, the Commission issued Order No. 380-A,[3] which (1) grants a stay until November 1, 1984, with respect to the application of the final rule to minimum physical take provisions in pipeline rate schedules or tariffs; (2) clarifies that Order No. 380 does not apply to the stream of revenue approved by the Commission in authorizing the Alaska Natural Gas Transportation System; (3) grants a waiver of section 154.111 of the Commission's regulations, to the extent set forth in the body of the Order, with respect to Trunkline LNG Company; and (4) denies all other petitions for rehearing.

A number of petitioners filed requests for clarification and/or rehearing of Order No. 380 with respect to the application of the final rule to "minimum take" provisions in pipeline tariffs or in contracts with customers. Petitioners contended that since the application of the final rule to "minimum take" provisions was not expressly mentioned in the Notice of Proposed Rulemaking issued August 25, 1983,[4] application of the rule to minimum take provisions was outside the scope of the Notice. They also contended that there was insufficient record evidence to support the Commission's findings that minimum take provisions in pipeline tariffs are unjust and unreasonable. In order to accommodate the concerns raised by petitioners, the Commission stated that it would reconsider the question of applying the rule to

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49 Fed. Reg. 22,778 (1984), FERC Stats, and Regs. ¶ 30,571 (1984).

[3] Order No. 380-A, Docket Nos. RM83-71-001 through 030, Order Denying Rehearing and Granting in Part Applications for Stay, 28 FERC ¶ 61,175 (1984), 49 Fed. Reg. 31,259 (1984), FERC Stats. and Regs. ¶ 30,584 (1984).

[4] Notice of Proposed Rulemaking, Docket No. RM83-71-000, 24 FERC ¶ 61,254 (1983), 48 Fed. Reg. 39,238, (1983); FERC Stats. and Regs., Proposed Regulations ¶ 32,334 (1983).

minimum take provisions[5] and would issue a supplemental notice in this docket seeking further comment on the minimum take issue.

A Notice of Request for Further Comment was issued on August 10, 1984, providing for initial comments to be received on or before August 30, 1984, and reply comments to be received on or before September 13, 1984.[6]

This aspect of the rulemaking proceeding reconsiders whether the rule, as promulgated, should be applied to minimum take provisions in pipeline rate schedules or tariffs.[7] The Commission is considering whether the use of a minimum take provision which requires a customer to take and pay for a specific quantity of gas regardless of price results in pipelines charging customers a rate in excess of the lowest reasonable rate consistent with reliable, long-term supply. The Commission is also considering

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[5] A minimum take provision, unlike a minimum commodity bill, requires the customer to physically take possession of the gas. The customer does not have an option to simply pay for gas and not take it. According to a number of commenters, refusal to take the gas constitutes a breach of the contract, absent a valid claim of *force majeure*. *See e.g.*, Transwestern Pipeline Company, Rate Schedule CDQ-1, FERC Gas Tariff, Second Revised Vol. No. 1, Original Sheet No. 8; Arkansas Louisiana Gas Company, Rate Schedule X-26, FERC Gas Tariff, Original Vol. No. 3, First Revised Sheet No. 180: Pacific Gas Transmission Company, FERC Gas Tariff, First Revised Vol. No. 1, First Revised Sheet No. 53. While minimum take provisions generally take this form, they may vary depending on the contractual arrangements agreed to by the parties. *See e.g.*, Reply Comments of Michigan Consolidated Gas Company and Inter-City Gas Corporation, filed September 13, 1984.

[6] Notice of Reguest for Further Comment, Docket No. RM83-71-001 through 030, 28 FERC ¶ 61,210 (1984), 49 Fed. Reg. 32,764 (1984) (cited hereinafter as "Notice").

[7] The rule does not apply to minimum take provisions in contracts between producers and pipelines. The rule only applies to the tariffs and rate schedules under which jurisdictional pipelines sell natural gas to their customers.

whether minimum take provisions share fully the market-distorting influences of variable costs in.minimum commodity bills.

The presence of variable costs in a minimum commodity bill did two things which the Commission attempted to remedy. First, in cases where a customer was taking below its minimum commodity level, the minimum commodity bill operated to recover variable costs that were not actually incurred by the pipeline. Second, the minimum commodity bill served as a barrier to competition, thus inhibiting natural gas prices from responding to current market conditions.

The Commission is concerned that minimum take provisions do two things which must be remedied. First, the presence of minimum take provisions cause customers to take gas they would not otherwise take, thus resulting in charges to customers in excess of the lowest reasonable cost. Second, minimum take provisions, like minimum commodity bills, act as a restraint on competition because the pipelines and the producers remain artificially insulated from market risk.

III. Summary of Comments and Analysis

A. *Overview*

In response to the Notice requesting further comment, the Commission received sixteen initial comments reflecting the views of pipelines, distributors, a group of Canadian producers, a state regulatory commission and other entities. One commenter, the Independent Petroleum Association of Canada (IPAC), filed its initial comments five days late. While IPAC's comments are untimely, the Commission will accept the comments in view of the fact that no party has suffered a detriment as a result of the Commission's consideration of the late-filed comment. Nine comments in reply were received. *See* Appendix A.

The Commission's Office of Regulatory Analysis, the natural gas distributors, several jurisdictional natural gas pipelines, and

the state regulatory commission expressed overwhelming support for the application of the rule to minimum physical take provisions. According to these commenters, the minimum take provisions cause customers to take gas they would otherwise not take, thus resulting in excessive rates to the consumer. The commenters also contend that minimum take provisions have at least as harmful an effect on competition as do minimum commodity bills, and for the same reasons. One commenter suggests that they may well have an even more harmful effect on competition than minimum commodity bills. These commenters conclude that there exists no redeeming purpose served by minimum take provisions that would distinguish them from minimum commodity bills. These comments are discussed at length *infra*.

In contrast, five of the nine jurisdictional natural gas pipelines who filed comments, in addition to a group of Canadian producers, oppose the application of the rule to minimum take provisions. These commenters state that minimum take provisions are necessary to assure the revenue stream necessary to maintain a viable pipeline. They also state that minimum take provisions are necessary to ensure sales of associated gas or other gas volumes which must be taken due to operational constraints caused by reduced takes. They further contend that such provisions are necessary to avoid erratic demands on their system supply by partial requirements customers. These comments are also discussed at length *infra*.

Upon review of the comments filed, the Commission has concluded that the presence of minimum take provisions cause customers to purchase gas they would otherwise not purchase because of its impact on the cost of their operations. The record reflects that minimum take provisions operate to prevent purchasers from pursing a least-cost purchasing strategy, thereby resulting in charges to customers in excess of the lowest reasonable rate consistent with reliable, long-term supply. The Commission has also concluded that minimum take provisions in

pipeline tariffs and contracts share fully the market-distorting influences of the variable costs in minimum commodity bills. Minimum take provisions have at least as harmful an effect on the marketability of natural gas as minimum commodity bills, and for the same reasons. The reasons offered for their continued use do not outweigh these adverse effects. For these reasons, the Commission concludes that the rule, as promulgated, should remain applicable to minimum take provisions or any other provision which provides for recovery of variable costs for gas not taken by the buyer.

The rule as applied to minimum take provisions, as with minimum commodity bills, does not affect the pipeline's ability to seek recovery of fixed costs incurred as a result of a customer's failure to meet its minimum daily or annual purchase obligations. The pipeline is free to seek recovery of such costs in a general section 4 rate filing.

B. *Responses To Specific Questions*

The Commission posed four questions in its Notice requesting further comment. Comments were submitted on each of these questions.

1. What were the reasons for including such provisions in pipeline tariffs and do those reasons still apply?

While the commenters note that it is difficult to generalize with respect to the reasons for including such provisions in pipeline tariffs, they have identified two primary purposes served by the inclusion of minimum take provisions in their tariffs. First, they provide the pipeline with an assurance that it would have a means of disposing of certain volumes of gas which, for practical or contractual reasons, it was required to take from its suppliers. Second, they provide the pipeline with an assurance that it

would not be subject to sudden and large swings in demand on the part of the partial requirements customers.[8]

The pipeline's need for assurance that it would have a means of disposing of certain volumes of gas is based on the fact, assert these commenters, that the pipelines, in many cases, are contractually obligated to actually take-*and*-pay for specific quantities of gas from their suppliers/producers, an amount which is similar to the minimum take level contained in their tariffs. The commenters state that these contractual requirements are imposed by the producers because the producers need protection against the operational problems created by the failure to take casinghead gas and the failure to take from plants producing natural gas liquids. The commenters also state that, in many instances, low capacity wells must be produced to protect against water incursion and the total loss of production and recoverable reserves. In addition to operational constraints caused by reduced takes, producers may also be under a contractual obligation to produce gas in "paying quantities" in order to maintain the mineral leases after the expiration of the primary term of the lease. The commenters also state that the producers require minimum purchases in order to assure a revenue stream sufficient to enable them to make the investment necessary to produce and process the underlying gas stream.

According to Transwestern Pipeline Company (Transwestern) and Arkansas Louisiana Gas Company (Arkla), a pipeline's need to be protected against sudden and large swings in demand is due to the pipelines' limited storage capacity and its continued obligation to meet its customer's contract demand for gas. A

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[8] *See* Initial Comments filed by Transwestern Pipeline Company (Transwestern), Arkansas Louisiana Gas Company (Arkla), Pacific Gas Transmission Company (PGT), Pacific Gas and Electric Company (PG&E), and Independent Petroleum Association of Canada (IPAC), Docket No. RM83-71-001 through 030, filed August 30, 1984.

number of commenters have expressed concern about the inequities of having to stand ready to meet a customer's full contract demand, while at the same time being exposed to that customer choosing to swing off the system at any time. In addition, they state that reduced swings provide the pipeline with the ability to plan their gas acquisition and manage their gas supply.

A number of these commenters contend that the original justifications for the inclusion of minimum take provisions in tariffs are even more valid today. First, pipelines are still, and will continue to be, contractually obligated to meet certain minimum take requirements on behalf of their suppliers. They also note that there has not been a change in the requirements of producers with respect to the need for an assured minimum physical level of production. Second, pipelines must still acquire firm supplies in order to meet certificate obligations and their limited storage capacity does not provide the pipeline with the ability to absorb large quantities of gas at unexpected times. Third, the pipelines' exposure to reduced takes is exacerbated by the Commission's rule eliminating recovery of the variable cost portion of minimum commodity bills. They contend that these reasons support retention of minimum take provisions in pipeline rate schedules or tariffs.

The Commission finds that the reasons for inclusion of the minimum take provisions do not justify their continued use. The concerns raised by the pipelines that they will be unable to meet their contractual obligations with their suppliers/producers are exactly that — concerns. The pipeline may be able to meet its contractual obligations with its suppliers/producers regardless of the implementation of the rule.

Even if a pipeline is unable to meet its contractual obligations with suppliers/producers, this would not justify the continued use of a minimum take provision. The Commission is charged with the responsibility of protecting customers from excessive

rates and charges.[9] To allow the continued use of a provision which restricts a purchaser's ability to reduce its gas costs, in order to alleviate a pipeline's contractual liability resulting from reduced takes would run counter to the intent of the Natural Gas Act and the Commission's obligations thereunder. Moreover, there is no justification for penalizing all customers by restricting their ability to purchase lower-priced gas where it has not been demonstrated that there is a clear nexus between the pipeline's incurrence of contractual liability with its suppliers/producers and the pipeline customer's reduction in takes below minimum take levels. A pipeline may not actually incur contractual liability as a result of a particular customer's inability to meet its minimum take obligation because another customer may increase its takes above minimum take levels.

The Commission is aware of the concerns raised by the commenters in this regard, but concludes that there are less restrictive alternatives available. For instance, to the extent that a pipeline actually incurs liability as a result of failure to meet its contractual obligations with its suppliers/producers, the pipeline is free to file for recovery of those costs. At that time, the Commission will consider on a case-by-case basis whether such costs have been prudently incurred and should be allowed to be recovered by the pipeline.

In addition, the concerns raised by commenters regarding the need for assurance against operational constraints caused by reduced takes also do not justify the continued recovery of purchased gas costs for gas not taken by the buyer. None of the commenters opposing application of the rule to minimum take provisions have demonstrated that the application of the rule to minimum take provisions would render the pipelines unable to sell the amount of gas necessary to maintain, for example, casinghead or processing plant production and no domestic

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[9] FPC v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944).

producers have filed comments reflecting this concern. In addition, if pipelines are unable to meet these minimum production levels it would reflect the fact that the gas was not priced competitively. The producers are not likely to maintain high prices at the cost of losing valuable reserves.[10] If a specific amount of gas must be sole to maintain a well, the gas will, no doubt, be priced accordingly to accomplish that objective.

Similarly, minimum take provisions are not justified by the concerns raised by the pipelines that they will be unable to meet their customers' contract demands due to the erratic demand on their system supply, In essence, these commenters are asserting that they incur legitimate, prudent fixed costs in "standing by" to provide certificated service. They claim that the only way they can recover these costs is by being assured that their gas will be taken. We disagree. There is no clear nexus between the pipeline's incurring these costs and the minimum take obligation imposed on its customers. To the extent actual costs are incurred as a result of the erratic swings on its system, the pipeline is free to make changes in its rate structure to reflect these costs. The pipeline's customers and our Staff will then have an opportunity, in appropriate proceedings, to review the costs claimed. This is the essence of regulation under section 4 of the Natural Gas Act.

As discussed below, minimum take provisions restrict a purchaser's ability to reduce its gas costs and act as a restraint

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[10] Under state law governing contracts, it is generally the duty of the party injured through a breach of contract to mitigate damages and thus minimize the loss resulting from the breach. TCP Industries, Inc. v. Uniroyal, Inc., 661 F.2d 542 (6th Cir. 1981). Under the mitigation doctrine, the seller must use every reasonable effort within its power to minimize damages. In the case of natural gas, this might mean a reduction in price in order to sell gas and maintain production levels. Thus, a correct measure of damages might be the difference between the market price and the contract price at the time of the breach.

on competition. The record does not demonstrate that the purposes served by the inclusion of these provisions outweigh these adverse effects.

2. Would allowing minimum take provisions cause customers to purchase gas they would otherwise not take because of its impact upon the cost of their operations?

A number of commenters contend that the presence of minimum take provisions in pipeline rate schedules or tariffs cause customers to purchase gas they would otherwise not purchase because failure to take gas at minimum take levels constitutes a breach of contract and could result in damages which exceed the price of the gas.[11] Transwestern's 80 percent minimum daily take requirement in its tariff, under which Pacific Lighting Gas Supply Company (PLGS) purchases gas, provides a clear example of the impact minimum take provisions have on a customer's purchasing decisions. According to the California Public Utilities Commission (CPUC) and San Diego Gas & Electric Company, Transwestern's minimum take provision has caused PLGS and, in turn, Southern California Gas Company Gas Company (SoCal), who purchases gas from PLGS, to reject lower-priced gas available from El Paso Natural Gas Company (El Paso) that they would otherwise have purchased to minimize their gas costs.[12] PLGS confirmed this

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[11] *See* Initial Comments filed by California Public Utilities Comm'n (CPUC), Southwest Gas Corp., Arizona Public Service Co., Southern Union Gas Co., Gas Company of New Mexico, San Diego Gas & Electric Co. (San Diego) and Commission Staff, Docket No. RM83-71-001 through 030, filed August 30, 1984.

[12] *See* Initial Comments of CPUC and San Diego. Under the tariffs which became effective April 1, 1984, (Docket No. TA84-2-42), PLGS purchased gas from Transwestern under Rate Schedules CDQ-1 and LX which reflected a commodity rate of $3.8102 per dekatherm (dth) and 3.8416 per dth, respectively. At the same time, SoCal was purchasing gas from El Paso under Rate Schedule G at a commodity rate of $3.5670 per dth.

fact by stating that "[u]nder present purchasing policies and conditions any shift away from Transwestern will have the result of the purchase of more El Paso gas".[13]

No commenter disputes the fact that the presence of minimum take provisions affect customers' purchasing decisions. However, those favoring retention of the minimum take provision argue that, in certain circumstances, mandating a certain level of sales may result in the purchase of lower-priced gas supplies, rather than the purchase of higher-priced gas which the Commission is attempting to eliminate.

Transwestern was one such commenter advancing this argument. Transwestern explains that it sells gas to PLGS who, in turn, sells gas to SoCal for distribution in southern California. According to Transwestern, absent a minimum take requirement, PLGS and, in turn, SoCal would improperly favor their affiliates over Transwestern as a result of their unique brand of sequencing gas purchases. Tanswestern explains that this would occur as a result of SoCal implementing its "avoidable cost" principle, whereby a decision to purchase gas is not based on price alone, but rather on its "avoidable cost".[14] According to Transwestern, at least in the case of southern California customers, retention of its minimum take provision might force the purchase of lower-priced gas supplies.[15]

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[13] *See* Reply Comments of PLGS and SoCal, Docket No. RM83-71-001, filed September 13, 1984, at 5. The Commission's decision is not altered by the fact that effective October 1, 1984, Transwestern's commodity rate under Rate Schedules CDQ-1 and LX is below that currently available from El Paso under Rate Schedule G. Our goal is to establish regulatory ground rules that will encourage the lowest reasonable rates consistent with reliable, long-term supply.

[14] The "avoidable cost" principle used by PLGS and SoCal is discussed in its reply comments at 5, *citing* the testimony of Mark C. Pocino filed in Docket No. RP83-113, *et al.*

[15] *See* Initial Comments of Transwestern at 13.

The Commission finds Transwestern's argument for retention of minimum take provisions unpersuasive. The Commission has no jurisdiction over how SoCal chooses to "sequence" its takes of natural gas. However, the CPUC requires the California utilities to pursue a least-cost purchasing policy for both their near-term and long-term purchases of natural gas. The prudence of the purchasing practices of PLGS, SoCal and other distribution companies are reviewed by the CPUC semi-annually in gas cost adjustment proceedings. To the extent they pursue a practice which unjustly or unreasonably favors affiliated companies, or is otherwise imprudent, the state commission is empowered to take remedial action. We, in turn, must focus on regulating those companies which are subject to our jurisdiction. A jurisdictional pipeline will not be able to circumvent the purpose of the Natural Gas Act if it is free to chose an alternate source of gas supply, because its purchasing practices are similarly reviewed semi-annually in a purchased gas adjustment (PGA) proceeding.

The comments demonstrate that a purchase is more inclined to take the higher-priced gas than expose themselves to damages resulting from a claim involving breach of contract.

3. Do minimum take provisions result in charges to customers in excess of the lowest reasonable cost?

A number of commenters state that minimum take provisions result in charges to customers in excess of the lowest reasonable cost because minimum take provisions hamper the customers' ability to purchase the least expensive gas available.[16]

Several commenters contend that allowing minimum take provisions would not result in charges to customers in excess of the lowest reasonable cost. Pacific Gas and Electric Company (PG&E) contends that it "observes a 'least-cost' gas purchasing policy designed to protect California customers by ensuring

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[16] *See* Initial Comments of CPUC, San Diego, and Staff.

long-term reliable supplies of natural gas at the lowest reasonable cost".[17] According to PG&E the concept of "lowest reasonable cost" must encompass more than simply transitory pricing differences. Such an analysis must also include consideration of "long-term pricing effects, supply quantity and reliability, and long-term gas needs".[18] The Commission agrees that these factors should be considered in establishing a comprehensive purchasing policy, but also states that a purchaser should not be restricted from selecting an alternate source of gas supply in order to provide its customers with gas at the lowest reasonable cost consistent with reliable, long-term supply.

Transwestern contends that minimum take provisions do not result in charges to customers in excess of the lowest reasonable cost because regulation prohibits the pipeline from charging unjust and unreasonable rates regardless of whether their tariffs contain minimum take provisions. Where, as in the instant proceeding, the Commission finds that a tariff provision, by its very terms, restricts a purchaser's ability to reduce its gas costs, it is clearly within its authority to prescribe the practice to be thereafter observed. The Commission need not consider the effects of such a provision on a case-by-case basis, as Transwestern suggests.

Transwestern also asserts that the Commission cannot and should not disregard the fact that it is dealing with a regulated industry, and thus, should not "attempt to translate competitive concepts applicable to a non-regulated market willy-nilly into transactions regulated under the Natural Gas Act."[19] Contrary to Transwestern's assertions, the Commission is not applying competitive concepts without consideration of the role competition should play in a regulated industry. As the Commission

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[17] *See* Initial Comments filed by PGT/PG&E at 5-6.

[18] *Id.*

[19] *See* Initial Comments filed by Transwestern at 17-18.

stated in *City of Florence, Alabama* v. *Tennessee Gas Pipeline Co.*, 24 FERC ¶ 61,395 at 61,839 (1983), competition can and should play an important role even in a regulated industry such as the natural gas industry. "If competition exists, incentives are created for innovation by the regulated companies. This, in turn, encourages lower prices and better service." This is precisely what the Commission is attempting to do by adapting our regulations to respond to evolving competitive forces.

The Commission has consistently encouraged regulated companies to pursue a least-cost purchasing policy in order to provide their customers with the lowest reasonable rate consistent with reliable, long-term supply. *See* Order No. 380, 27 FERC ¶ 61,318 (1984), mimeo at 22-23, Opinion No. 186, 24 FERC ¶ 61,299 at 61,638-40 (1983), and Order No. 298, 23 FERC ¶ 61,224 (1983), FERC Stats. and Regs. ¶ 30,455 (1983). The Commission has concluded that a provision which mandates a specific level of sales, regardless of price and marketability of gas supplies, limits the ability of that pipeline's customers to strictly adhere to a least-cost purchasing policy. A provision which unreasonably restricts a least-cost purchasing policy results in charges to customers in excess of the lowest reasonable cost.

4. What is the effect of minimum take provisions on the marketability of natural gas?

According to most commenters, minimum take provisions, like minimum commodity bills, have a substantial and debilitating effect on the marketability of natural gas.[20] One commenter stated that minimum take provisions are even more harmful to competition than minimum commodity bills because when the unmarketable gas is actually taken by the pipeline the producers

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[20] *See* Initial Comments filed by Northern Indiana Public Service Comm'n, Process Gas Consumers Group, *et al.*, Southwest Gas Corp., *et al.*, CPUC, San Diego Gas & Electric Co., and Staff, Docket No. RM83-71-001 through 030, filed August 30, 1984.

remain ignorant to the fact that it is unmarketable.[21] This commenter further notes that having sold this high-priced gas, the producer may be encouraged to explore for additional supplies to replace those sold, thereby perpetuating an already bad situation. In response to this argument, one commenter stated that producers are well aware of the marketing problems faced by their buyers and are conducting their exploration and development activities accordingly.[22]

If, as suggested, the producers are aware of the marketing problems associated with the sale of their high-priced gas and are already conducting their operations accordingly, they do not need to require the pipeline and, in turn, the pipeline's customers to purchase a specific quantity of gas. If the gas is competitively priced it will be sold.

Transwestern contends that its minimum take provision has "absolutely no effect on the marketability of the gas," because it provides for a *pro rata* reduction in take obligations under certain circumstances.[23] Transwestern's *pro rata* reduction in takes does not eliminate the adverse effects minimum take provisions have on a purchaser's ability to reject unmarketable gas, as discussed *infra*.

Pacific Gas Transmission/Pacific Gas and Electric Company (PGT/PG&E), who filed joint comments, contend that minimum take provisions do not themselves affect marketability. They explain that it is only when high minimum take provisions are combined with excessive prices that there is a potential adverse effect on marketability.[24] According to PGT/PG&E, its minimum take provisions do not adversely effect marketability because at the time of filing these comments its minimum take

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[21] *See* Initial Comments of Staff at 3-6.

[22] *See* Reply Comments of Arkla at 4-5.

[23] *See* Initial Comments of Transwestern at 17-18.

[24] *See* Initial Comments of PGT/PG&E at 7-8.

level had been reduced to 40 percent of the daily contract quantity and 50 percent on an annual basis, and new Canadian natural gas policies were implemented which will allow negotiated prices and enable Canadian prices to be reduced. Subsequently, PGT filed, in Docket No. RP85-2-000, to completely eliminate PG&E's minimum physical take obligations, with respect to its purchase of Canadian gas imports, substitute an "equitable purchase" clause based on achieving and maintaining a competitive price for the Canadian supply, reduce the annual take-or-pay level from 60 percent to 50 percent of the daily contract quantity, and alter the make-up rights for previously incurred take-or-pay, with such changes to be effective November 1, 1984, assuming receipt of necessary regulatory approvals.

The Commission finds, based upon a review of the record, that the minimum take provisions share fully the market-distorting influences of the variable cost portion of minimum commodity bills, and for the same reasons. Both minimum take provisions and minimum commodity bills provide substantial financial pressure on a pipeline's customers to not reduce takes below the level of the applicable minimum. Thus, both provisions represent artificial constraints on the purchaser's choice of how much gas to purchase and at what price. A customer faced with a requirement to take a specific quantity of gas regardless of price or breach a contract becomes essentially indifferent to price. The resulting effect is that the pipeline and, in turn, the producers become artificially insulated from true market conditions and no longer have an opportunity to increase sales by adjusting the price. As we stated in Order No. 380, sellers, in an unregulated market, who are willing to accept a price that is below the prevailing price are generally able to increase their sales volumes. This ability to exchange price concessions for increased sales volumes is essential to the efficient functioning of a price responsive market.

C. *Other General Issues*

In addition to responding to the specific questions raised by the Commission in its Notice, a number of commenters have raised other issues regarding the application of the rule to minimum take provisions, which are addressed below.

1. Effect On Terms And Conditions Under Which A Pipeline Renders A Certificated Service

Similar to the argument raised on rehearing of Order No. 380, several commenters state that the minimum take provision in their tariff is a central and integral part of the certificate approved by the Commission. As such, they assert, it cannot be significantly or substantially altered by the Commission absent an adjudicatory proceeding.[25]

One commenter contends that: "the minimum take provision is not a term or condition of service, rather it is 'the service' ", the essence of the service which has been approved by the Commission, and which forms the basis of the design of the facilities utilized to effect the sale and receipt of volumes.[26] In short, the commenter contends that the minimum take provision is the heart of the agreement and cannot be altered without significantly altering the balance between the parties that resulted from negotiation of the contract and the service undertaken upon acceptance of the certificate.

A minimum take provision, like a minimum commodity bill, merely represents a term or condition of service as set forth in the pipeline's tariff. As such, is represents one of many tariff provisions taken into consideration by the Commission in granting a certificate.[27] As we stated in Order No. 380-A, the alteration of pipeline tariffs which will result from applying the rule is

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[25] *See* Initial Comments of Arkla and Transwestern.

[26] See Initial Comments of Arkla at 5.

[27] Pipelines are generally granted certificates on the basis of maximum throughput, not minimum takes.

clearly within the Commission's authority as set forth in sections 4, 5 and 16 of the Natural Gas Act.[28] The Commission's authority in this regard is clearly set forth at pages 7-9 of Order No. 380-A and need not be repeated here.

In sum, section 5(a), when read in concert with the broad language of section 16, permits the Commission to alter and amend the terms and conditions under which a pipeline renders a certificated service when the Commission determines, as in the instant proceeding, that those terms or conditions result in unjust and unreasonable rates. Accordingly, this argument is rejected.

2. Requirement For An Adjudicatory Proceeding

Several commenters also argue that even if proceedings under section 5 are lawful, factual issues raised by the Commission's proposal would preclude Commission action without an adjudicatory hearing to resolve the material issues of fact raised by the proposal and to make the type of findings required by section 5.[29]

The Commission disagrees. If, as in the instant case, there is neither a dispute as to material facts, nor a need to discover the underlying facts to aid in policy determinations, the Commission is under no obligation to grant the party an adjudicatory hearing. *See United States* v. *Storer Broadcasting Co.*, 351 U.S. 192, 205 (1956); *Jersey Central Power & Light Co.* v. *F.E.R.C.*, 730 F.2d 816 (D.C. Cir. 1984); *Citizens for Allegan County, Inc.* v. *F.P.C.*, 414 F.2d 1125 (D.C. Cir. 1969). The Commission has considered the factual issues raised by the commenters in this phase of the proceeding and has concluded that no issues of fact raised by the commenters warrant the need for an adjudicatory proceeding. The factual issues raised by commenters are addressed *infra*.

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[28] 15 U.S.C. § 717-717w (1976).

[29] *See* Initial Comments of Arkla, Transwestern, PGT/PG&E.

The Commission has also concluded that the problems resulting from inclusion of minimum take provisions are so pervasive as to affect the industry as a whole, thus supporting the need to resolve this matter on a generic basis, as opposed to considering these issues on a pipeline-by-pipeline basis. The legal precedent for such an approach is clearly set forth at pages 45-49 of Order No. 380 and need not be repeated here.

3. Effect on Negotiated Contracts

Several commenters argue that when tariff provisions are a matter of private contract, the Commission may not make a finding that the provision is unjust and unreasonable absent "circumstances of unequivocal public necessity". *Citing United Gas Pipe Line Co.* v. *Mobile Gas Service Corporation,* 350 U.S. 332 (1956) and *FPC* v. *Sierra Pacific Power Co.,* 350 U.S. 348 (1956) (hereinafter referred to as *"Mobile-Sierra"* doctrine.[30] According to these commenters, the Commission has not attempted to find, and the record would not permit a finding, that retention of the minimum take provision would impair the pipeline's customers' financial ability to continue to render service to the public. One commenter also asserts that such a finding cannot be made on a generic basis in a rulemaking proceeding.[31] The commenters' contentions are without merit.

First, the *Mobile-Sierra* doctrine only applies to fixed-price contracts and none of the commenters who raise this argument have shown that they are operating under fixed-price contracts.

Second, even if the contracts affected by the rule are fixed-price contracts, the *Mobile-Sierra* doctrine does not impair "the regulatory powers of the Commission, for the contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest." 350 U.S. at 344. A similar argument was rejected by the Supreme Court in

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[30] *See* Initial Comments of Arkla and Transwestern.

[31] *See* Initial Comments of Transwestern at 22.

F.P.C. v. *Louisiana Power & Light Co.*, 406 U.S. 621, 646-47 (1972).

The *Mobile-Sierra* doctrine merely enables a purchaser of gas to enter into a fixed-price contract with the assurance that those rates will not change *absent* a Commission determination under section 5(a) that the fixed rate is unjust or unreasonable. The instant proceeding involves a determination under section 5(a) that the presence of minimum take provisions prevent customers from purchasing lower-priced gas, thus resulting in charges to customers in excess of the lowest reasonable rate. Minimum take provisions have also been found to be anticompetitive. For these reasons, the Commission has concluded that minimum take provisions in pipeline rate schedules or tariffs are contrary to the public interest and should be modified accordingly.

4. Establishing An Appropriate Non-discriminatory Level For Minimum Takes

While there was overwhelming support for applying the rule to minimum bill provisions, several commenters stated that minimum take provisions at appropriately determined and non-discriminatory levels can serve a useful purpose.[32] One commenter noted that some reasonable level of minimum take can serve a public purpose in maintaining the viability of each of several suppliers to a common market, thus helping to insure the availability of reliable sources of gas supply at reasonable prices to consumers over the long-term.[33]

The only evidence submitted proposing the establishment of an appropriate level for minimum takes was provided by El Paso. Under the approach advanced by El Paso, the level of minimum takes would be set "to insure, at a minimum, that

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[32] *See* Initial Comments of Columbia Gas Transmission Corporation and El Paso. Docket No. RM83-71-001 through 030, filed August 3, 1984.

[33] *See* Initial Comments of El Paso at 4.

adequate and reliable supplies of gas are available over the longer term to those higher-priority consumers which constitute the purchaser's 'core market' ".[34] Takes by the common purchaser from each supplier would be ratable up to an established threshold[35] in instances where, as today, gas supply exceeds demand.[36] Each pipeline, under this approach, would be assured of attaining a certain minimum level of sales since it would bear only its *pro rata* share of any downturn in the market below the minimum take level. Above the minimum level, takes would be permitted on a least cost basis. According to El Paso, such an approach would provide pipelines and their suppliers with at least some minimum assurance of a market for their gas if they are to remain viable.[37]

PGT/PG&E, who filed joint reply comments, oppose El Paso's approach arguing that such an approach would not foster price competition. According to PGT/PG&E, there is a need for flexibility in minimum take provisions and recognition that such a provision should reflect particular conditions of the system.[38]

The Commission finds, based on the evidence presented, that minimum take provisions *at any level* are anticompetitive and can result in unjust and unreasonable rates or charges to the extent they restrict a purchaser's ability to purchase gas at the lowest reasonable cost. While the Commission is concerned

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[34] *See* Initial Comments of El Paso at 4, *citing* the testimony of El Paso's witness C. R. Jack, Docket No. RP83-113, *et al.*, filed February 21, 1984.

[35] *Id.*, El Paso presented testimony in Pacific Gas Transmission Co., *et al.*, Docket No. RP83-113, *et al.*, recommending that the appropriate minimum take level for the southern California market should be set at 60 percent of the volumes available from all interstate suppliers to that market. *Id.*

[36] El Paso notes that exceptions might be allowed where the suppliers' sole supply of gas is casinghead or associated gas production. Initial Comments of El Paso at 4, n. 3.

[37] *See* Initial Comments of El Paso at 4-5.

[38] *See* Reply Comments of PGT/PG&E at 5.

about the long-term availability of gas supplies, the Commission does not believe that minimum take provisions provide such an assurance. To the extent that special circumstances exist which support the pipeline's need to mandate a particular level of sales regardless of price, that pipeline is free to file a petition for waiver of the regulations under 18 C.F.R. § 385.207. The Commission reiterates that it will not be generally inclined to grant exceptions to the rule in light of the strong public interest considerations that it embodies.

5. Interstate versus Intrastate Pipelines

One commenter, Transwestern, asserts that the application of the rule to minimum take provisions would have the effect of severely disadvantaging interstate pipelines vis-a-vis their intrastate competitors. Transwestern also asserts that such action is contrary to the intent of Congress in enacting the Natural Gas Policy Act of 1978 (NGPA).[39] According to Transwestern, a critical Congressional policy embodied in the NGPA was to put interstate and intrastate pipelines on an equal footing in competing for gas supplies. Transwestern contends that because the Commission's rule would only reach jurisdictional interstate pipelines, it would place them at a significant disadvantage in competing for gas supplies against an intrastate pipeline who can guarantee a supplier/producer a certain percentage of sales, regardless of price.

Based upon a review of the record, the Commission finds that this argument has no more merit than when it was raised by Transwestern on rehearing of Order No. 380. In addition to our addressing this argument at page 57-58 of Order No. 380-A, we note that no evidence has been presented which demonstrates that applying the rule to minimum take provisions would severely disadvantage interstate pipelines in their attempt to

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[39] *See* Initial Comments of Transwestern at 22-24.

acquire natural gas supplies.[40] Transwestern was the only commenter which has raised this argument and Transwestern has neither alleged nor shown that it competes for gas supplies with any intrastate pipelines. Moreover, the fact that the Commission does not have jurisdiction over intrastate pipelines cannot be used as a basis for frustrating the Commission's regulation of interstate pipelines.

IV. Requests for Waivers and/or Clarification[41]

A. *Arkansas Louisiana Gas Company (Arkla)*

Arkla asserts (at 21) that the "unique factual circumstances" that exist on its customer's system (Northwest Central Pipeline Corporation), warrant waiver of any rule that would otherwise eliminate the minimum take provision in the Arkla-Northwest Central contract. It bases this assertion on the following factual situation.

Arkla has a daily minimum purchase obligation in its Rate Schedule X-26 under which it sells gas to Northwest Central Pipeline Corporation (Northwest Central), the successor to Cities Service Gas Company, at Jane, Missouri. Arkla contends that if its minimum take provision in its X-26 rate schedule is eliminated, Northwest Central will not purchase Arkla's gas for the following reasons. First, Northwest Central has substantial take-or-pay obligations under its contracts with certain Wyoming producers. Under these contracts, Northwest Central is required to take-or-pay for a certain quantity of high-priced gas. Second, the Commission has imposed a minimum throughput condition in the certificate issued to Northwest Central authorizing the construction and operation of Northwest

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[40] Transwestern has not submitted data demonstrating to what extent intrastate pipeline contracts and tariffs contain minimum take provisions.

[41] A number of requests have been filed for waiver of the rule as applied to minimum commodity bills. *See* Great Lakes Gas Transmission Company, Docket Nos. RP84-10-1-000, et al.

Central's Rawlins-Hesston line to Wyoming. Under that condition, Northwest Central is exposed to underrecovery of costs of that line to the extent throughput falls below a specific minimum level, specifically 43 Bcf per year.[42]

According to Arkla, because Northwest Central's shareholders will bear the brunt of any undercollection resulting from the Rawlins-Hesston line, Northwest Central has every incentive to maintain throughput on that line, regardless of the price of the gas purchased from the Wyoming producers. Consequently, if Arkla's minimum take provision is eliminated, Northwest Central would have a strong economic incentive to swing off its system in order to assure recovery of the fixed costs of the Rawlins-Hesston line.

In addition, Arkla notes that Northwest Central has the contractual right to take substantial volumes of lower-priced gas from the Hugoton producers in Kansas. Arkla contends that absent an obligation to take gas from Arkla, Northwest Central would increase its takes of this lower-priced gas to offset the effects of its increase in purchases of higher-priced gas from the Wyoming producers.

Assuming all the facts set forth by Arkla to be true, the Commission sees no reason to exempt the minimum take provision in the Arkla-Northwest Central contract from the rule. The throughput condition imposed on Northwest Central "does not require Cities [now Northwest Central] to transport a minimum amount of gas through the Rawlins-Hesston line".[43] Rather, it is a ratemaking mechanism used for the purpose of placing an

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[42] The condition was imposed by the Commission "to protect Northwest Central's ratepayers from bearing the full risks that the record has disclosed were involved in the proposed project." Northwest Central Pipeline Corp., 26 FERC ¶ 61,372 at 61,827 (1984).

[43] Cities Service Gas Co., Docket No. CP76-500-001, 23 FERC ¶ 61,193 at 61,410, n. 2 (1983).

appropriate amount of risk on Northwest Central's shareholders. The condition does *not* relieve Northwest Central of its duty to provide gas at the lowest reasonable rate. As the Commission specifically stated:

> [T]he minimum throughput condition does not exempt any volumes purchased and transported through the Rawlins-Hesston line from the general inquiry into [Northwest Central's] prudence in its gas acquisition practices.[44]

Thus, Northwest Central's minimum throughput condition does not allow Northwest Central to engage in imprudent gas purchasing practices. What appears to be Arkla's concern, as one commenter noted,[45] is not the fact that Northwest Central will increase its takes of higher-priced gas from the Wyoming producers; rather, that Northwest Central will increase its takes from the Hugoton producers who are offering lower-priced gas.

Based upon the foregoing, the Commission finds that Arkla has failed to demonstrate that unique factual circumstances exist sufficient to grant waiver of the application of the rule to the Arkla-Northwest Central contract.

B. *Pacific Gas Transmission Company (PGT)*
Pacific Gas & Electric Company (PG&E)

PGT/PG&E filed comments stating that the minimum take provisions of the type set forth in the PGT/PG&E Service Agreement should not be governed by the rule. Subsequently, PGT filed to eliminate this minimum take provision with respect to PG&E's purchases of Canadian gas imports and substitute an "equitable purchase" clause, as discussed *supra*. Because Docket No. RP85-2-000 is pending Commission action and the minimum take provisions contained in the PGT/PG&E Service Agreement are still in effect, the Commission will address the

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[44] *Id.*, at 61,410.

[45] *See* Reply Comments of Staff at 13.

arguments raised by PGT/PG&E in their comments filed in this proceeding.

According to PGT/PG&E, the characteristics of minimum take provisions described by the Notice as synonymous with "a minimum purchase requirement or a take-*and*-pay provision", are not characteristic of the PGT/PG&E Service Agreement. Among other differences, PGT/PG&E notes:

> [t]he minimum take definition set forth in the Notice assumes that the full commodity price is paid for gas not taken. The PGT/PG&E Service Agreement is not such a take-*and*-pay arrangement. If PG&E fails to take gas at the minimum levels, PG&E is *not* required to pay PGT in any event for the minimum volumes. Rather, a failure by PG&E to meet the minimum take obligation under the PGT tariff involves a breach of contract, absent a "force majeure" situation.[46]

The rule was intended to eliminate a pipeline's ability to recover purchased gas costs for gas not taken by the buyer. This includes the pipeline's attempt to recover damages for breach of contract where the damages represent the purchase gas costs for gas not taken by the buyer. Thus, as one commenter noted, the PGT/PG&E distinction is a distinction without a difference.

PGT/PG&E also argues that their minimum take provision differs from those contemplated by the Notice because there is a direct link between the minimum take provisions contained in the PGT/PG&E contract and the take-and-pay PGT has with its Canadian suppliers, Alberta and Southern. PGT/PG&E notes that the minimum volumes reflected in these contracts are based on volumes authorized by the National Energy Board (NEB) for export under the licenses held by Alberta and Southern, and the corresponding Section 3 import authorizations held by PGT which are issued by and under the jurisdiction

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[46] Initial Comments of PGT/PG&E at 4-5.

of the Economic Regulatory Administration (ERA).[47] PGT states that it has one pipeline sales customer, PG&E, and serves only one market. PGT further states that it is merely an arm of the distributor PG&E, created to serve an interstate jurisdictional link between PG&E and the Alberta gas producers from whom Southern and Alberta purchases gas. As such, PGT contends that if its minimum take provision is modified or eliminated it will have a direct and significant adverse effect on the Canadian producers, who starting November 1, 1984, will have the freedom to negotiate prices with their customers.[48] Thus, PGT/PG&E asserts that to apply the rule to their minimum take provisions would be inconsistent with established governmental policy regarding Canadian imports.[49] They also assert that the Commission lacks authority to act on PGT's Canadian gas imports in the manner which may result from applying the rule to the PGT/PG&E minimum take provision.

The Commission rejects these arguments for the following reasons. First, as the Commission stated in Order No. 380-A, at pages 88-91, Order No. 380 is not inconsistent with the established government policy regarding Canadian imports as set forth in the *New Policy Guidelines And Delegation Orders On The Regulation Of Imported Natural Gas*, 49 Fed. Reg. 6684 (1984), issued recently by ERA.[50]

Second, the rule does not apply to minimum take provisions in any contracts between foreign and domestic companies. The rule only applies to the tariffs and rate schedules under which jurisdictional pipelines sell natural gas to their customers. The fact

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[47] *See* Order 380-A, mimeo at 83, n. 46.

[48] *See* Appendix A of Order No. 380-A.

[49] Joint Requests of PGT/PG&E for Clarification, Reconsideration and/or Rehearing, Docket No. RM83-71-001 through 030 filed June 25, 1984, at 39.

[50] *See* letter from Rayburn Hanzlik, Administrator, ERA, to Raymond J. O'Connor, Chairman, FERC, dated July 13, 1984.

that the Commission's ruling *may* adversely impact on the terms or conditions of a contract beyond the Commission's jurisdiction, a fact which has not been demonstrated by record evidence, cannot be relied upon to frustrate the Commission's authority to regulate interstate pipelines.

Third, the single market characteristic of the chain of contracts between PGT/PG&E and its supplier Alberta and Southern, and, in turn, the Alberta producers is not unique. The circumstances facing Canadian producers are analogous to those facing many pipeline suppliers and their producers. To exempt a pipeline from the rule because of the adverse affects on a Canadian producer, where domestic producers would be equally affected, would unfairly discriminate among pipelines and tend to perpetuate the very problems which the rule is intended to eliminate.

C. *Great Lakes Gas Transmission Company (Great Lakes)*

Great Lakes takes the position that the rule should not take effect under any circumstances. Great Lakes made a number of arguments in opposition to the application of the rule to minimum take provisions which have already been addressed above or in Order Nos. 380 and 380-A.

Several of Great Lakes' customers filed comments stating that Order Nos. 380 and 380-A should govern Great Lakes' minimum take provision because it is in actuality a minimum commodity bill.[51] The Commission need not decide whether the Great Lakes' provision is in actuality a minimum take or a minimum commodity bill because the rule is equally applicable to both.

In addition to arguments in opposition to the rule, Great Lakes requests clarification regarding how a pipeline, if it incurs

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[51] *See* Reply Comments of Michigan Consolidated Gas Co. and Inter-City Gas Corp., Docket No. RM83-71-001 through 030, filed September 13, 1984.

take-and-pay liability with its supplier, can recover such costs. Great Lakes asserts that "[i]t is unreasonable and unjust to have a situation whereby Great Lakes makes take-and-pay payments to [its supplier], but cannot receive corresponding payments from those customers whose failure to comply with their recent contract amendments cause Great Lakes to incur take-and-pay liability with [its supplier]."[52] It is Great Lakes' position that the only just and reasonable solution is to allocate the costs to those customers who have caused the pipeline to incur take-and-pay liability with its suppliers.

The Commission need not reach the issue of how costs incurred by the pipeline for take-and-pay liability with its suppliers will be recovered, because the Commission is not presently confronted with that issue. Indeed, the issue may never arise. But to the extent that it does, the pipeline is free to file for recovery of such costs in its rate case and the issue will be decided on a case-by-case basis.

With respect to Great Lakes' contention that such liability, if incurred, should be directly assigned, the Commission reiterates that such question of cost incurrence and cost responsibility may be addressed in appropriate rate proceedings.

D. *Transwestern Pipeline Company (Transwestern)*

Transwestern raises a number of arguments which have already been addressed above. In addition to the arguments addressed above, Transwestern contends that "the Rule carries the potential for denying the pipeline the opportunity to recover its costs".[53] Transwestern's argument is presented as follows. The Commission in Order No. 380 stated that due to the Commission's filing requirements and the five month suspension period ordered by the Commission in most rate cases, the pipeline could be required to carry for a period of approximately six

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[52] See Initial Comments of Great Lakes at 7.

[53] Initial Comments of Transwestern at 24.

months any increased costs resulting from load loss. Based on this statement, Transwestern concludes that "nonrecovery of at least six months' worth of the carrying costs of take-or-pay liability caused by the Commission's rule is automatic and could well be more than the pipeline could financially withstand". Transwestern contends that this would be so in its case.[54]

As we stated in Order No. 380-A at pages 59-60, the pipeline has some flexibility in managing its take-or-pay costs during a suspension period because, in most instances, take-or-pay liability is determined on an annual basis, based on the "contract year" of each contract. If the company does find itself in a severe financial condition as a result of take-or-pay carrying costs, the Commission can suspend the company's filing for only one day, where circumstances so warrant. Moreover, a pipeline has some control over the price of its "mix" of gas supply. For example, effective one day after the effective date of Order No. 380 and 380-A, Transwestern reduced the price it pays under "market out" type clauses from $4.00 to $2.95, thereby making possible a significant reduction in its purchased gas costs.[55] Decreased prices will mean increased takes which, in turn, translates into reduced take-or-pay liability.

E. *Colorado Interstate Gas Company (CIG) And MIGC, Inc. (MIGC)*

CIG urges the Commission to apply the rule to the minimum take provisions in pipeline tariffs, as well as to all contracts or agreements between jurisdictional pipelines and their resale customers which establish a physical minimum take level on the part of such customers.[56] CIG's principal concern regards the

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[54] *Id.*, at 25.

[55] *See* Transwestern Pipeline Co., Docket No. TA85-1-42-000 and 001 Schedule A-2.

[56] *See* Initial Comments of Colorado Interstate Gas Co., Docket No. RM83-71-001 through 030, filed August 30, 1984, at 4.

rule's applicability to an Interim Agreement[57] entered into between CIG and MIGC on December 20, 1983, which governs the terms and conditions of a sale for resale of natural gas in interstate commerce.

MIGC responded in its reply comments that CIG is requesting that the Commission improperly extend the rule to apply to a judgment entered by a Judge in the United States District Court for the District of Wyoming.[58] On July 26, 1983, MIGC instituted a proceeding in the United States District Court for the District of Wyoming, *MIGC, Inc.* v. *Colorado Interstate Gas Company*, No. C83-0299, in which MIGC brought action against CIG alleging certain tariff and contractual violations. On July 28, 1983, CIG filed with the Commission a complaint and request for an order to show cause in Docket No. RP83-116-000, alleging certain tariff and certificate violations with respect to MIGC's sales of gas to CIG. On October 11, 1983, CIG filed a petition for declaratory order assigned Docket No. RP84-7-000, which requested the Commission to state that CIG has no minimum bill obligation to MIGC for the 1983 contract year. On October 4, 1983, the Commission denied CIG's request for a show cause proceeding and ordered CIG to reopen its purchase valve.[59] On December 20, 1983, MIGC and CIG entered into an "Interim Agreement" which provides, *inter alia*, that CIG will accept up to 32,000 MMBtu of gas per day. The Interim Agreement is currently in effect and, by its terms, will remain in effect until the Commission issues a final non-appealable order in Docket No. RP84-7-000,[60] but in no event

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[57] This "Interim Agreement" is not on file with the Commission regardless of the fact that CIG is currently purchasing gas from MIGC in accordance with its terms and conditions.

[58] *See* Reply Comments of MIGC, Inc., Docket No. RM83-71-001 through 030, filed September 13, 1984, at 1.

[59] 25 FERC ¶ 61,000 (1983).

[60] CIG's petition for a declaratory order in Docket No. RP84-7-000 has been consolidated with MIGC's general rate case in Docket

later than June 30, 1986. On December 22, 1983, the Judge in the United States District Court issued an order approving the settlement agreement (Interim Agreement) and dismissing the action without prejudice.

According to MIGC, the Interim Agreement was intended to establish a working relationship between MIGC and CIG pending a resolution of these issues in Docket No. RP84-7-000. MIGC contends that because the purpose of the Interim Agreement was to permit a working relationship to exist between MIGC and CIG pending litigation regarding MIGC's tariff, the Interim Agreement, by its terms does not operate or vary the terms or conditions of any contract or arrangement between the parties. MIGC also contends that CIG wrongfully urges the Commission to regard the Interim Agreement as though it were part of MIGC's tariff and, as such, to modify it. MIGC asserts that for the Commission to do this would "involve the Commission in a wrongful collateral attack on the District Court Order and would be contrary to both law and policy."[61]

The questions confronting the Commission in the instant proceeding concern: (1) whether the Interim Agreement constitutes a contract governing the terms and conditions for the jurisdictional sale of natural gas in interstate commerce and, therefore, should be on file with the Commission; and (2) whether the District Court's approval of the Interim Agreement and dismissal of the complaint action takes the matter outside the purview of the Natural Gas Act.

MIGC is an interstate pipeline engaged in the transportation and sale for resale of natural gas in interstate commerce and thus is subject to this Commission's jurisdiction under the Natural Gas Act. 15 U.S.C. 717 *et seq.* Congress has provided

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No. RP84-15-000, 25 FERC ¶ 61,309 (1983), and three of MIGC's PGA filings in Docket Nos. TA83-2-47-000, TA84-1-47-000, and TA84-2-47-001, 26 FERC ¶ 61,369 and 27 FERC ¶ 61,163 (1984).

[61] *Id.*, at 2.

in section 4(c) of that Act, that all natural gas companies subject to the Commission's jurisdiction shall file with the Commission "all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the charges, *together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.*" (Emphasis added) 15 U.S.C. 171c(c). This provision has the effect of giving certainty to both buyers and sellers of natural gas in the interstate market, since only the rate filed with the Commission may be charged.[62]

Under the terms of the Interim Agreement, MIGC is obligated to deliver and CIG is obligated to accept and pay for the quantity of gas set forth in the Agreement, until a final, nonappealable order resolving Commission docket No. RP84-7-000 is issued or June 30, 1986, whichever is earlier. While the Interim Agreement does not operate to alter or vary the underlying terms or conditions of any contract or agreement between the parties, it does constitute a contract affecting or relating to rates during the interim period. As such, it should have been filed by MIGC as part of its FERC Gas Tariff as required by the Natural Gas Act. Accordingly, MIGC is ordered to file the Interim Agreement as part of its FERC Tariff in accordance with the Act.

All contracts which are or should be on file with the Commission are under the exclusive jurisdiction of the Commission regarding a determination as to whether the rate or charge is "just and reasonable". 15 U.S.C. § 717c(a). *Montana Dakota* v. *Northwestern Public Services Co.*, 341 U.S. 246, 250 (1951). *See e.g., Maryland* v. *Louisiana*, 451 U.S. 725, 746-752 (1981); *F.P.C.* v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972); *Northern Natural Gas Co.* v. *State Corporation Commission of*

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[62] *See* Transwestern Pipeline Co., Docket No. RP81-130-000, *et al.*, 27 FERC ¶ 61,255 at 61,481 (1984); Michigan Wisconsin Pipe Line Co., Opinion No. 471, 34 FPC 621, 626 (1965).

Kansas, 372 U.S. 84 (1963). Thus, the Commission's authority to prescribe just and reasonable rates will extend to the Interim Agreement entered into between MIGC and CIG.

In sum, the Commission finds that the Interim Agreement governs the terms and conditions for the jurisdictional sale of natural gas in interstate commerce and, thus, should be on file with the Commission in accordance with section 4 of the NGA. All such contracts are subject to the Commission's exclusive jurisdiction to determine just and reasonable rates or charges. Therefore, the Commission's rule with respect to minimum take provisions applies to the Interim Agreement which should be on file with the Commission.

F. *Pan Alberta Gas Ltd. and Foothills Pipe Lines (Yukon) Ltd. (Pan Alberta/Foothills)*

Pan Alberta/Foothills requests that if the Commission reaffirms its decision to apply the rule broadly to minimum take provisions, that it continue to ensure that the tariffs underlying the minimum revenue stream established for the pre-built portions of the Alaska Natural Gas Transportation System project are exempted in accordance with the findings in Order No. 380-A.

The Commission hereby confirms that the rule as applied to minimum take provisions does not apply to the stream of revenue defined in the orders issued by the Commission[63] authorizing the construction and operation of the "pre-built" portions of the United States segment of the Alaska Natural Gas Transportation System, for the reasons stated in Order No. 380-A, which will not be repeated here.

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[63] *See* Order 380-A, at 96, n. 62.

G. *Independent Petroleum Association of Canada (IPAC)*

IPAC, a group which represents 200 Canadian producers, suggests (at 2) that minimum take provisions in existing contracts be allowed to stand until modified by the parties. According to IPAC, extending minimum take provisions beyond November 1, 1984, to a date appropriate in each case, will provide protection to consumers consistent with the intent of the Commission in issuing Order Nos. 380 and 380-A.

The Commission rejects this suggestion because the pipelines have been made aware of the Commission's inquiry into this matter for over a year. Thus, the pipelines have had sufficient time to begin renegotiating the terms of their contracts which would ultimately be affected by the implementation of this rule. The Commission rejects IPAC's suggestion and affirms that the rule as applied to minimum take provisions will become effective November 1, 1984.

H. *Algonquin Gas Transmission Company (Algonquin)*

In addition to the arguments raised in Algonquin's pleadings on rehearing, which are incorporated by reference and which have been addressed above, Algonquin requests that the Commission clarify that "the rule in not applicable to such physical take provisions where the service itself or service reliability may be threatened if the minimum take provisions are not enforced."[64]

The Commission has considered all of the comments in this phase of the proceeding regarding the impact application of the rule will have on service reliability. These comments fail to demonstrate that the pipeline's ability to continue to serve its customers will be threatened if the minimum take provisions are not enforced. If Algonquin believes that its ability to continue to

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[64] Initial Comments of Algonquin Gas Transmission Co., Docket No. RM83-71-001 through 030, filed August 30, 1984, at 2.

serve its customers is threatened without a minimum take provision, Algonquin is free to file for a waiver of the regulation.

I. *Columbia Gas Transmission Corporation (Columbia)*

Columbia, which neither sells nor purchases gas under tariffs containing minimum take provisions, believes that the Commission should recognize that while minimum purchase requirements may not be proper in all (or even most) circumstances, special circumstances may exist under which such arrangements are appropriate and consistent with the overall public interest.

The Commission acknowledges that special circumstances may exist under which the minimum take provision may be considered appropriate and in the public interest. Those circumstances have not been demonstrated nor is the Commission aware of any circumstances which would justify the use of a minimum take provision in light of their adverse effect on competition. Nevertheless, as noted above, any person is free to file a petition for waiver of that regulation who believes the unique factual circumstances justify an exemption.

V. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act (RFA)[65] requires certain statements, descriptions, and analyses of proposed rules that will have "a significant economic impact on a substantial number of small entities."[66] The Commission is not required to make an RFA analysis if it certifies that a proposed rule will not have "a significant economic impact on a substantial number of small entities."[67]

The rule affects the contents of tariffs filed by pipelines which are regulated as natural gas companies under the Natural Gas

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[65] Section 8, 5 U.S.C. §§ 601-612 (1982).

[66] *Id.*, § 603(a).

[67] *Id.*, § 605(b).

Act. These regulated pipelines are virtually all large-size companies that do not fall within the RFA's definition of small entity.[68] The rule denies these regulated natural gas companies the ability to recover purchased gas costs for gas not taken by the buyer, regardless of what form that requirement takes in a pipeline's rate schedule or tariff. By making the rule applicable to take minimum take provisions, no additional refiling requirements are imposed on the pipeline.

Accordingly, the Commission certifies that this rule as applied to minimum take provisions will not have a significant economic impact on a substantial number of small entities.

The Commission Orders:

(A) Section 154.111 of the Commission's regulations will apply to minimum take provisions as the Commission stated in Order Nos. 380 and 380-A and the stay will be lifted as of November 1, 1984.

(B) All requests for waiver, as described in the body of this order, are hereby denied.

(C) MIGC, Inc. shall file, within 7 days of the issuance of this order, an Interim Agreement between MIGC and CIG, dated December 20, 1983, as part of its FERC Gas Tariff.

By the Commission.

(S E A L)

KENNETH F. PLUMB
Kenneth F. Plumb,
Secretary.

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[68] *Id.*, § 601(3)-(6). *See* Order No. 380, pp. 58-59, n. 62.

APPENDIX A

Initial Comments

Algonquin Gas Transmission Company
Arkansas Louisiana Gas Company
California Public Utilities Commission
Colorado Interstate Gas Company
Columbia Gas Transmission Corporation
El Paso Natural Gas Company
Federal Energy Regulatory Commission Staff
Great Lakes Gas Transmission Company
Independent Petroleum Association of Canada
Northern Indiana Public Service Company
Pacific Gas Transmission Company and
  Pacific Gas & Electric Company
Pan-Alberta Gas Ltd. and
  Foothills Pipe Lines (Yukon) Ltd.
Process Gas Consumers Group, *et al.*
San Diego Gas & Electric Company
Southwest Gas Corporation, *et al.*
Transwestern Pipeline Company

Reply Comments

Arkansas Louisiana Gas Company ·
Federal Energy Regulatory Commission Staff
Inter-City Gas Corporation
Michigan Consolidated Gas Company
MIGC, Inc.
Pacific Gas Transmission Company and
Pacific Gas & Electric Company
Southern California Gas Company and
Pacific Lighting Gas Supply Company
Southwest Gas Corporation, *et al.*
Transwestern Pipeline Company

APPENDIX H

COMMISSION OPINIONS, ORDERS AND NOTICES

Before Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, A. G. Sousa, Oliver G. Richard III and Charles G. Stalon.

Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions	Docket Nos. RM83-71-035 through RM83-71-038

ORDER NO. 380-D
ORDER DENYING REHEARING AND MOTION FOR STAY OF ORDER NO. 380-C

(Issued December 21, 1984)

I. INTRODUCTION

The Federal Energy Regulatory Commission (Commission) has received four requests for rehearing[1] and a motion for stay[2] of Order No. 380-C.[3] This order denies all four requests for rehearing and MIGC, Inc's (MIGC) request for stay of Order No. 380-C.

II. BACKGROUND

On October 24, 1984, the Commission issued Order No. 380-C which reaffirmed the application of the minimum bill rule to minimum take provisions in pipeline rate schedules or tariffs, denied requests for waiver filed by Arkansas Louisiana Gas

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[1] The requests for rehearing were filed by: (1) Transwestern Pipeline Company; (2) Arkansas-Louisiana Gas Company; (3) Algonquin Gas Transmission Company; and (4) MIGC, Inc.

[2] The motion for stay of Order No. 380-C was filed by MIGC, Inc.

[3] Order No. 380-C, Docket Nos. RM83-71-001 through 030, *Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, [FERC Statutes and Regulations* ¶30,607] 49 Fed. Reg. 43,625 (Oct. 31, 1984).

Company (Arkla) and Pacific Gas Transmission Company and directed MIGC, Inc. (MIGC) to file an Interim Agreement, dated December 20, 1983, as part of its FERC Gas Tariff. On November 23, 1984, requests for rehearing were filed by MIGC, Arkla, Transwestern Pipeline Company (Transwestern), and Algonquin Gas Transmission Company (Algonquin). On December 6, 1984, MIGC also filed a motion for stay of Order No. 380-C.

III. Issues on Rehearing

A. *Procedural Objections*

The petitioners assert many procedural objections regarding the Commission's ruling in Order No. 380-C. After giving each objection full consideration, we find that none has merit. Indeed, we believe only one of the petitioners' procedural claims warrant discussion. This claim concerns petitioners' asserted right to an evidentiary hearing.

Petitioners assert that the factual issues on which the Commission has made findings are matters in dispute which cannot be resolved absent an evidentiary proceeding. The petitioners contend that when factual issues are in dispute, as in the instant proceeding, the Commission is required by the substantial evidence test contained in section 19 of the Natural Gas Act to go beyond bare notice and comment procedures to provide an evidentiary hearing complete with the presentation of witnesses and cross-examination. Petitioners' claim that the procedures used in establishing the instant rule denied them their statutory right to an adjudicatory hearing under the Natural Gas Act are not well-founded.

A trial-type hearing is cumbersome and unnecessary in informal rulemakings. Such a hearing is useful in deciding disputed adjudicative facts, not in resolving legislative facts, such as those at issue here. Legislative facts are defined as:

> The facts which help the tribunal to determine the content of law and of policy and help the tribunal exercise its judgement or discretion in determining what course of action to take. Legislative facts are general and do not concern the immediate parties.[4]

The record contains facts regarding what effect minimum take provisions have on the ability of the pipelines to pursue a least-cost purchasing policy and whether those provisions act as a barrier to competition. Those facts are legislative in nature because they assist the Commission in establishing a policy regarding the continued use of minimum take provisions. While any rule may adversely affect individual parties, its prospective effect and generic application militates against unfairness to any person. To the extent those individual parties adversely affected believe that unique factual circumstances distinguish them from the norm, they may file for a waiver of the regulations. As we stated in Order No. 380 [*FERC Statutes and Regulations* ¶ 30,571], generic action on this subject is in the public interest and the Commission has adequate authority to act under section 5 of the Natural Gas Act by means of rulemaking. (See Order No. 380 at pp. 45-49.)

B. *Other Objections Raised*

Several petitioners on rehearing raise issue with the rule as it applies in certain instances. MIGC and Arkla on rehearing argue against application of the rule in certain factual circumstances related only to their systems. They do not make clear whether these situations reflect those of other natural gas pipelines. The Commission's Order No. 380-C was based on a

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[4] Davis, Administrative Law Text, 1972, Section 15.03 at p. 296.

thorough examination of the circumstances of many pipelines, including the petitioners'. As discussed below and in Order No. 380-C, none of these arguments raised on rehearing dissuade the Commission from its finding that the rule, as promulgated, is reasonable and should apply to minimum take provisions in all pipeline rate schedules or tariffs.

1. MIGC, INC.

All of the arguments raised on rehearing by MIGC address the application of the rule to the specific facts on its system. MIGC's arguments could have been better framed in terms of a request for waiver of the rule as applied to the Interim Agreement, but the Commission does not consider that MIGC has yet requested such a waiver. For purposes of expedition, the Commission will discuss the specific facts raised by MIGC here.

MIGC asserts that: (1) the Commission's findings that eliminating minimum take provisions will allow purchasers to reduce costs by following a least-cost purchasing strategy are unfounded as demonstrated in MIGC's case; (2) the Commission failed to consider MIGC's situation and, as applied to MIGC, its analysis and assumptions are invalid; and (3) the Commission erred in ordering MIGC to file the Interim Agreement. (at pp. 6-23) The Commission has considered the factual circumstances on MIGC's system and has concluded that as applied to MIGC, the Commission's analyses and assumptions are valid.

In support of its contention that the Commission's findings are unfounded, MIGC states that following the issuance of Order No. 380-C "CIG has confirmed that it has not and will not follow a least-cost purchasing strategy." (at p. 8) MIGC states that this is borne out by the fact that following the issuance of Order No. 380-C, CIG informed MIGC that it was reducing its takes from MIGC by 30 percent, regardless of the fact that "[a] significant portion of the gas CIG is currently purchasing is more expensive than MIGC's gas . . ." (at p. 9) In Order No.

380-C, the Commission did not state that purchasers *would pursue* a least-cost purchasing strategy, but that the elimination of minimum take provisions *would enable* pipelines to pursue a least-cost purchasing strategy. To the extent a jurisdictional pipeline's gas costs do not reflect prudent purchasing practices or it unjustly or unreasonably favors affiliated companies, a remedy is available.

MIGC also argues that the Commission failed to consider situations such as exist on MIGC's system and, therefore, the Commission's analysis and assumptions are invalid. (at pp. 12-17) MIGC again relies on the fact that nearly all of its supply is made up of casinghead and processing plant gas and the application of this rule will render MIGC unable to sell the amount of gas necessary to maintain production levels. (at pp. 13-14) MIGC is also concerned that if it is unable to guarantee its suppliers/producers a market for this gas, they will no longer continue to provide MIGC with a reliable source of gas supply. The Commission is not persuaded by these arguments. MIGC has not demonstrated that the application of this rule will cause MIGC's suppliers/producers operational problems resulting from reduced takes. As we have repeatedly stated, if operational problems result from reduced takes, producers will be more inclined to reduce prices in order to market the gas. The rule is intended to encourage producers to reduce prices to market clearing levels. With respect to MIGC's contention that it will no longer be guaranteed a reliable source of gas supply, it is very unlikely that MIGC's producers/suppliers will turn away a buyer willing to take its casinghead and processing plant production.

Finally, MIGC contends that the Commission erred in ordering MIGC to file the December 20, 1983 Interim Agreement. (at p. 20) In support of this contention, MIGC states that the Interim Agreement has no effect on the rate CIG must pay for MIGC's gas and CIG is the only purchaser under MIGC's Rate

Schedule PL-1; therefore, there is no lack of certainty on CIG's part as to the rate in effect for MIGC's gas. (at pp. 20-22) MIGC also states that regardless of whether the Interim Agreement should be on file with the Commission, the Commission had no basis to extend its minimum bill rule to modify the Interim Agreement because the Commission made no attempt to consider the unique circumstances surrounding the MIGC/CIG Agreement, and failed to consider the effects of applying the rule to the Interim Agreement. (at p. 22)

The Commission has not erred in ordering MIGC to file the Interim Agreement because "all contracts which in any manner affect or relate to such rates, charges, classifications, and services" are to be filed with the Commission in accordance with section 4(c) of the Natural Gas Act.[5] It is clear that the terms and conditions of service as set forth in the Interim Agreement affect or relate to the rates, charges or services rendered by MIGC.

Contrary to MIGC's assertions, the Commission has considered the circumstances surrounding the execution of the Interim Agreement and the effects of applying the rule to that Interim Agreement. The Commission finds, however, that these facts do not demonstrate that the rule as applied to MIGC is invalid. Accordingly, MIGC's request for rehearing is denied.

2. Arkansas-Louisiana Gas Company

Arkla asserts that the Commission's refusal to grant it a waiver of the minimum bill rule was arbitrary and capricious. In support of its assertion, Arkla states that: (1) the Commission's action encourages the purchase of high-cost gas, thereby insulating high-cost producers from competition and encouraging further discrimination by Northwest Central Pipeline Corporation (Northwest Central); (2) the Commission has ignored the operational and contractual impact of its orders; and (3) the

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[5] 15 U.S.C. § 717c(e).

Commission's orders will cause Arkla irreparable harm. The Commission is not persuaded by these arguments.

Arkla contends that the Commission incorrectly assumed that removal of Arkla's minimum take provisions would enhance price competition. According to Arkla, the Commission ignored the relatively low cost of Arkla's gas, as well as what was actually occurring in the marketplace. (at p. 7) The Commission's order eliminating minimum take provisions to the extent they recover gas costs for gas not taken does *not* encourage the purchase of high-cost gas. On the contrary, it eliminates certain barriers which inhibited a pipeline from pursuing a least-cost purchasing strategy. What Arkla and other petitioners complain about is not what the rule actually does, but what it fails to do. For instance, Arkla's complaint is not with the fact that the rule will allow purchasers to seek less expensive gas, but rather that its customers, given the option, will not purchase the least expensive gas available because of other contractual obligations. In this proceeding, the Commission was only attempting to remedy the problems caused by the inclusion of minimum take provisions in pipeline rate schedules or tariffs. The Commission did not undertake to resolve all of the problems related to individual pipelines' purchasing practices, but neither has it turned a blind eye to the practices cited by Arkla and the other petitioners. Rather, those matters are more appropriately considered in future proceedings when those pipelines file to adjust their rates to recover the purchased gas costs in question.

Arkla's second and third contentions concern the operational and contractual impact of the Commission's orders on its system. According to Arkla, elimination of its minimum take provisions is subjecting Arkla to wide swings in gas demands which could result in a reduction in deliveries to Arkla's Priority 6 customers. (at pp. 15-16) Arkla further contends that because the Commission's intentions with respect to minimum take provisions was not known until July 1984, there was insufficient

time for Arkla to attempt to adjust its operations and obligations to accommodate this substantial altering of the service rendered to Northwest Central. According to Arkla, absent a waiver of the Commission's rule, it will suffer irreparable harm. (at pp. 15-18) The Commission, as discussed in Order No. 380-C, has considered the operational and contractual impact of its orders on Arkla and is not persuaded that subjecting Arkla to the rule will cause Arkla irreparable harm.

For these reasons, Arkla's request for rehearing is denied.

3. Algonquin Gas Transmission Company and Transwestern Pipeline Company

Algonquin and Transwestern have raised the same or similar arguments as those addressed above or in Order No. 380-C. For that reason, they will not be repeated here. The requests for rehearing of Algonquin and Transwestern are hereby denied.

The Commission has considered all of the other issues raised on rehearing and concluded that only the issues discussed above merit response. All of the other issues not addressed above have already been fully considered and addressed in the 380 series of orders.

IV. Motion for Stay

On December 6, 1984, MIGC filed a motion for stay of Order No. 380-C pending consideration of MIGC's request for rehearing of that order and any subsequent court review.

The key element in the Commission's determination of whether to grant a stay is whether the moving party has demonstrated that it will be irreparably injured in the absence of a stay. *Ozark Gas Transmission System,* 17 FERC ¶ 61,235 (1981). Upon review of MIGC's motion, we find that MIGC's assertion of irreparable injury is without merit.[6] MIGC has not

[6] We furthermore are not persuaded by MIGC's assertion that the merits of its appeal are such that it is likely to succeed in the appellate court.

shown good cause warranting a stay of Order No. 380-C. We will therefore deny MIGC's motion.

V. Clarification

Several questions have arisen concerning the scope of the rule with respect to the recovery of fixed costs associated with minimum take provisions. In Order No. 380-C, mimeo at p. 7, the Commission incorrectly stated that the pipeline is free to seek recovery of such costs in a general section 4 rate filing. Minimum take provisions remain currently effective except to the extent that they operate to recover variable costs for gas not taken by the buyer. The Commission in Order No. 380-C only eliminated the recovery of *variable* costs under a pipeline's minimum take provision. In other words, minimum take provisions are treated in the same manner as minimum commodity bills. The *fixed* cost component included in a selling pipeline's commodity rate may still be recovered by that seller for the number of units of gas specified in the minimum take provision even where the buyer does not take that specified minimum amount. Otherwise, these purchasers would be relieved of the cost responsibility for fixed costs associated with the service as well as responsibility for variable costs of gas not taken. As a result, these purchasers would be better off than purchasers under a minimum commodity bill. The Commission does not intend this to result from the present rule.

The Commission orders:

(A) For the reasons stated in the body of this order, the requests for rehearing filed by MIGC, Arkla, Transwestern, and Algonquin are hereby denied.

(B) MIGC's motion for stay of Order No. 380-C is hereby denied.

APPENDIX I

NATURAL GAS ACT

§ 5(a), 15 U.S.C. § 717d(a) (1982).

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

§ 7(b), 15 U.S.C. § 717f(b) (1982).

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

§ 7(c), 15 U.S.C. § 717f(c) (1982).

(1)(A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area of which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be unlawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section

temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of —

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

§ 7(e), 15 U.S.C. § 717f(e) (1982).

Except in the cases governed by the provisos contained in subsection (c)(1) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

§ 19(b), 15 U.S.C. § 717r(b) (1982).

Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the [circuit] court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has it principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after

the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended.

APPENDIX J

ADMINISTRATIVE PROCEDURE ACT

§ 4, 5 U.S.C. § 553 (1982).

(a) This section applies, according to the provisions thereof, except to the extent that there is involved —

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include —

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply —

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments

with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except —

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

§ 5, 5 U.S.C. § 554 (1982).

(a) This section applies, according to the provisions thereof, in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved —

(1) a matter subject to a subsequent trial of the law and the facts de novo in a court;

(2) the selection or tenure of an employee, except a administrative law judge appointed under section 3105 of this title;

(3) proceedings in which decisions rest solely on inspections, tests, or elections;

(4) the conduct of military or foreign affairs functions;

(5) cases in which an agency is acting as an agent for a court; or

(6) the certification of worker representatives.

(b) Persons entitled to notice of an agency hearing shall be timely informed of —

(1) the time, place and nature of the hearing;

(2) the legal authority and jurisdiction under which the hearing is to be held; and

(3) the matters of fact and law asserted.

When private persons are the moving parties, other parties to the proceeding shall give prompt notice of issues controverted in fact or law; and in other instances agencies may by rule require responsive pleading. In fixing the time and place for hearings, due regard shall be had for the convenience and necessity of the parties or their representatives.

(c) The agency shall give all interested parties opportunity for —

(1) the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment when time, the nature of the proceeding, and the public interest permit; and

(2) to the extent that the parties are unable so to determine a controversy by consent, hearing and decision on notice and in accordance with sections 556 and 557 of this title.

(d) The employee who presides at the reception of evidence pursuant to section 556 of this title shall make the recommended decision or initial decision required by section 557 of this title, unless he becomes unavailable to the agency. Except to the extent required for the disposition of ex parte matters as authorized by law, such an employee may not —

(1) consult a person or party on a fact of issue, unless on notice and opportunity for all parties to participate; or

(2) be responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for an agency.

An employee or agent engaged in the performance of investigative or prosecuting functions for an agency in a case may not, in that or a factually related case, participate or advise in the

decision, recommended decision, or agency review pursuant to section 557 of this title, except as witness or counsel in public proceedings. This subsection does not apply —

(A) in determining applications for initial licenses;

(B) to proceedings involving the validity or application of rates, facilities, or practices of public utilities or carriers; or

(C) to the agency or a member or members of the body comprising the agency.

(e) The agency, with like effect as in the case of other orders, and in its sound discretion, may issue a declaratory order to terminate a controversy or remove uncertainty.

§ 7, 5 U.S.C. § 556 (1982).

(a) This section applies, according the provisions thereof, to hearings required by section 553 or 554 of this title to be conducted in accordance with this section.

(b) There shall preside at the taking of evidence —

(1) the agency;

(2) one or more members of the body which comprises the agency; or

(3) one or more hearing examiners appointed under section 3105 of this title.

This subchapter does not supersede the conduct of specified classes of proceedings, in whole or in part, by or before boards or other employees specially provided for by or designated under statute. The functions of presiding employees and of employees participating in decisions in accordance with section 557 of this title shall be conducted in an impartial manner. A presiding or participating employee may at any time disqualify himself. On the filing in good faith of a timely and sufficient affidavit of personal bias or other disqualification of a presiding or participating employee, the agency shall determine the matter as a part of the record and decision in the case.

(c) Subject to published rules of the agency and within its powers, employees presiding at hearings may —

(1) administer oaths and affirmations;

(2) issue subpenas authorized by law;

(3) rule on offers of proof and receive relevant evidence;

(4) take depositions or have depositions taken when the ends of justice would be served;

(5) regulate the course of the hearing;

(6) hold conferences for the settlement or simplification of the issues by consent of the parties;

(7) dispose of procedural requests or similar matters;

(8) make or recommend decisions in accordance with section 557 of this title; and

(9) take other action authorized by agency rule consistent with this subchapter.

(d) Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence. A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence. The agency may, to the extent consistent with the interests of justice and the policy of the underlying statutes administered by the agency, consider a violation of section 557(d) of this title sufficient grounds for a decision adverse to a party who has knowingly committed such violation or knowingly caused such violation to occur. A party is entitled to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts. In rule making or determining claims for money or benefits or application for initial licenses an agency may, when a party will not be

prejudiced thereby, adopt procedures for the submission of all or part of the evidence in written form.

(e) The transcript of testimony and exhibits, together with all papers and requests filed in accordance with section 557 of this title and, on payment of lawfully prescribed costs, shall be made available to the parties. When an agency decision rests on official notice of a material fact not appearing in the evidence in the record, a party is entitled, on timely request, to an opportunity to show the contrary.

§ 8, 5 U.S.C. § 557 (1982)

(a) This section applies, according to the provisions thereof, when a hearing is required to be conducted in accordance with section 556 of this title.

(b) When the agency did not preside at the reception of the evidence, the presiding employee or, in cases not subject to section 554 (d) of this title, an employee qualified to preside at hearings pursuant to section 556 of this title, shall initially decide the case unless the agency requires, either in specific cases or by general rule, the entire record to be certified to it for decision. When the presiding employee makes an initial decision, that decision then becomes the decision of the agency without further proceedings unless there is an appeal to, or review on motion of, the agency within time provided by rule. On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule. When the agency makes the decision without having presided at the reception of the evidence, the presiding employee or an employee qualified to preside at hearings pursuant to section 556 of this title shall first recommend a decision, except that in rule making or determining applications for initial licenses—

(1) instead thereof the agency may issue a tentative decision or one of its responsible employees may recommend a decision; or

(2) this procedure may be omitted in a case in which the agency finds on the record that due and timely execution of its functions imperatively and unavoidably so requires.

(c) Before a recommended, initial, or tentative decision, or a decision on agency review of the decision of subordinate employees, the parties are entitled to a reasonable opportunity to submit for the consideration of the employees participating in the decisions —

(1) proposed findings and conclusions; or

(2) exceptions to the decision or recommended decisions of subordinate employees or to tentative agency decisions; and

(3) supporting reasons for the exceptions or proposed findings or conclusions.

The record shall show the ruling on each finding, conclusion, or exception presented. All decisions, including initial, recommended, and tentative decisions, are a part of the record and shall include a statement of —

(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and

(B) the appropriate rule, order, sanction, relief, or denial thereof.

(d)(1) In any agency proceeding which is subject to subsection (a) of this section, except to the extent required for the disposition of ex parte matters as authorized by law —

(A) no interested person outside the agency shall make or knowingly cause to be made to any member of the body comprising the agency, administrative law judge, or other employee who is or may reasonably be expected to be involved in the decisional process of the proceeding, an ex parte communication relevant to the merits of the proceeding;

(B) no member of the body comprising the agency, administrative law judge, or other employee who is or may reasonably be expected to be involved in the decisional

process of the proceeding, shall make or knowingly cause to be made to any interested person outside the agency an ex parte communication relevant to the merits of the proceeding;

(C) a member of the body comprising the agency, administrative law judge, or other employee who is or may reasonably be expected to be involved in the decisional process of such proceeding who receives, or who makes or knowingly causes to be made, a communication prohibited by this subsection shall place on the public record of the proceeding:

(i) all such written communications

(ii) memoranda stating the substance of all such oral communications; and

(iii) all written responses, and memoranda stating the substance of all oral responses, to the materials described in clauses (i) and (ii) of this subparagraph;

(D) upon receipt of a communication knowingly made or knowingly caused to be made by a party in violation of this subsection, the agency, administrative law judge, or other employee presiding at the hearing may, to the extent consistent with the interests of justice and the policy of the underlying statues, require the party to show cause why his claim or interest in the proceeding should not be dismissed, denied, disregarded, or otherwise adversely affected on account of such violation; and

(E) the prohibitions of this subsection shall apply beginning at such time as the agency may designate, but in no case shall they begin to apply later than the time at which a proceeding is noticed for hearing unless the person responsible for the communication has knowledge that it will be noticed, in which case the prohibitions shall apply beginning at the time of his acquisition of such knowledge.

(2) This subsection does not constitute authority to withhold information from Congress.

APPENDIX K

DEPARTMENT OF ENERGY ORGANIZATION ACT

§ 403(c), 42 U.S.C. § 7173(c) (1982).

Any function described in section 402 of this Act which relates to the establishment of rates and charges under the Federal Power Act [16 U.S.C.A. § 791a et seq.] or the Natural Gas Act [15 U.S.C.A. § 717 et seq.], may be conducted by rulemaking procedures. Except as provided in subsection (d), the procedures in such a rulemaking proceeding shall assure full consideration of the issues and an opportunity for interested persons to present their views.

APPENDIX L

FEDERAL POWER ACT

§ 206(a), 16 U.S.C. § 824e(a) (1982).

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affected such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

§ 313(b), 16 U.S.C. § 825l(b) (1982).

Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States court of appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the

order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new finding which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended.

APPENDIX M

THE CONSTITUTION OF THE UNITED STATES

Amendment V

No person shall be held to answer for a capital or other infamous crime unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service, in time of war or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation.

FILED
FEB 10 1986
JOSEPH F. SPANIOL, JR.
CLERK

Nos. 85-1219, *et al.*

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF OF RESPONDENTS TENNESSEE GAS PIPELINE COMPANY AND MIDWESTERN GAS TRANSMISSION COMPANY IN SUPPORT OF PETITIONS FOR WRIT OF CERTIORARI

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February 10, 1986

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

List Of Affiliates Of Tennessee Gas Pipeline Company And Midwestern Gas Transmission Company Who Are Not *Wholly Owned By Tenneco Inc. Pursuant To Rule 28.1*

Adela Investment Company S.A.
Akulu Marchon (PTY) Ltd.
Akulu Chemicals (PTY) Ltd.
Albright, Morarji and Pandit Limited
Albright & Wilson (Australia) Ltd.
Albright & Wilson Match Phosphorous Co. Ltd.
Arndale Fuels Ltd.
Bracey Petroleum Products Ltd.
Butler Oil Products Ltd.
Case Poclain GmbH & Co.
Collins Pipeline Company
Depositas Del Norte, S.A.
FC Marine Inc.
Gardinol Products (PTY), Ltd.
HT Gathering Company
Intertractor Viehmann GmbH & Co.
J.I. Case do Brasil & Cia.
Kern Island Water Company
Kern River Canal and Irrigating Company
Kern River Gas Transmission Company
Losenhausen Maschinenbau AG & Co.
Losenhausen Maschinenbau AG
Marchon-Paragon Holdings (PTY) Limited
Marchon-Paragon Sulphonation (Cape) (PTY) Ltd.
Marchon-Paragon Sulphonation (PTY) Ltd.
Mistal Inc.
Monroe Auto Pecas S.A.
National Brands (PTY), Ltd.

Omni-Pac GmbH
P.P.M. Guindastes Hidraulicos S.A.
Pholyphosphates Inc.
Poclain S.A.
S.A. Paper Chemicals (Proprietary), Limited
Sara Gretes Cafetria AB
Skogstre A/S
Stoco Mutual Water and Sewer Company
T & M Terminal Company
Tees Storage Company Limited
Tenneco Insurance Ventures Inc.
Tenneco Oil Company of Nigeria Unlimited
Tenneco Oil of Nigeria Unlimited
Tenngasco Gas Gathering Company
Tess Storage Company Limited
TENN-USS Chemicals Finance Corporation
Tractortechnic Canada, Ltd.
Universal Chemical Contractors (PTY)
Vibromax France SARL
Vibromax France SCI
W.R. John & Company (Rumney) Ltd.

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IN THE

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OCTOBER TERM, 1985

Nos. 85-1219, *et al.*

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v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

---

BRIEF OF RESPONDENTS TENNESSEE GAS PIPELINE COMPANY AND MIDWESTERN GAS TRANSMISSION COMPANY IN SUPPORT OF PETITIONS FOR WRIT OF CERTIORARI

Tennessee Gas Pipeline Company (Tennessee) and Midwestern Gas Transmission Company (Midwestern)[1]

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[1]Tennessee and Midwestern were parties to the proceeding below. They are natural gas pipeline companies engaged primarily in the business of purchasing, transporting and selling

support the petitions for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit filed by Transwestern Pipeline Company (No. 85-1219), ANR Pipeline Company (No. 85-1236), Texas Eastern Transmission Corporation (No. 85-1237), Trunkline Gas Company and Panhandle Eastern Pipe Line Company (No. 85-1250), and Arkla Energy Resources (No. 85-1282). These petitions challenged a decision of the United States Court of Appeals for the District of Columbia Circuit (App. A-1)[2] upholding a series of rulemaking orders of the Federal Energy Regulatory Commission (Commission or FERC) that declared unlawful longstanding and previously authorized minimum contractual purchase

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natural gas in interstate commerce under authority granted by and subject to the jurisdiction of the Commission under the Natural Gas Act. Tennessee's main transmission system extends northeastward from its supply sources in Texas, Louisiana and the Gulf of Mexico into sixteen states terminating in New England. Its sales are made to gas distribution companies and other pipelines which resell the gas being ultimately consumed in twenty-two states, primarily in the Middle Atlantic, Midwest and New England regions. At the end of 1983, Tennessee had over three billion dollars of utility plant in service, including almost fourteen thousand total miles of pipeline. Midwestern has two separate pipeline systems. Midwestern's Southern System extends from Portland, Tennessee, where it purchases its gas supply from its affiliate, Tennessee, to Joliet, Illinois. It sells primarily to gas distributors who resell the gas in the greater Chicago-Gary area. Its Northern System buys natural gas from a Canadian supplier, and its principal customer is ANR Pipeline Company, which primarily serves the states of Wisconsin and Michigan. At the end of 1983, Midwestern had about one-hundred sixty million dollars of utility plant in service, including over nine hundred miles of pipeline.

[2]The appendix references are to the appendix filed with this Court by Transwestern.

commitments by pipeline customers that enabled the recovery of variable costs through minimum commodity bills.[3] In the interests of brevity, Tennessee and Midwestern hereby adopt the statements of the case, statutes involved, jurisdiction and opinions below submitted in the petition of Trunkline Gas Company and Panhandle Eastern Pipe Line Company.[4]

REASONS FOR GRANTING THE WRIT

This case involves fundamental and important questions concerning the Commission's authority to release partial requirements customers of pipelines from previously authorized and longstanding minimum purchase commitments while at the same time holding pipelines to their contractual agreement to provide certain maximum volumes to those customers upon demand. The case is not only vitally important to pipelines because they have made multi-million dollar investments in facilities and have entered into minimum gas purchase obligations with producers and suppliers in reliance on the contract provisions that have been set aside, but also to the pipelines' entire requirements customers who will have to bear a much greater portion of cost of service of the pipeline.

I.

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[3]These orders were issued in Commission Docket No. RM83-71 and are identified as Order No. 380 (App. A-71), 380-A (App. A-129), 380-B (App. A-226), 380-C (App. A-231), and 380-D (App. A-271).

[4]The issues addressed here relate to questions presented for review by Transwestern Pipeline Company and Texas Eastern Transmission Corporation.

FERC HAS DESTROYED THE BASIC CONTRACTUAL UNDERPINNINGS OF THE NATURAL GAS INDUSTRY WITHOUT SATISFYING THE REQUIREMENTS FOR SUCH CONTRACTUAL ABROGATION SET FORTH IN THIS COURT'S DECISIONS

Over the last thirty years in cases under the Natural Gas Act (15 U.S.C. § 717, *et seq.*), this Court has repeatedly recognized the importance of private contracts between interstate pipelines and their customers and has held that such contracts may be abrogated "only in circumstances of unequivocal public necessity." *In Re Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968), *citing United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *accord Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 582 (1981). The basis for this heavy burden was that "preserving the integrity of contracts . . . permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry." *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. at 344; *see also U.S.* v. *El Paso Natural Gas Co.*, 376 U.S. 651, 660 (1964) ("pipelines are very expensive; and to be justified they need long-term contracts for sale of gas that will travel them"); *Tampa Electric Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 334 (1962) ("in the case of public utilities the assurance of a steady and ample supply of fuel is necessary in the public interest. . . . The compelling validity of such considerations has been recognized fully in the natural gas public utility field.").

The court below did not determine whether the Commission's action abrogating these private con-

tracts met this Court's standard of "unequivocal public necessity." Thus, it requires review by this Court to determine whether contract provisions such as these can be abrogated under the Commission's rule without meeting this standard.

Review is further warranted because the Commission abrogated these contracts, notwithstanding the reliance placed on such contracts by interstate pipelines, such as Tennessee and Midwestern. It cannot be disputed that minimum commodity bills were essential parts of gas supply contracts entered into between interstate pipelines and their customers. In the case of Tennessee and Midwestern, the bargain struck with their partial requirements customers was that Tennessee and Midwestern would provide those customers with a specified firm volume of gas upon demand and the customers' payments would be subject to a minimum commodity bill based on $66^{2}/_{3}\%$ of the monthly volume they were entitled to demand. In this way, the partial requirements customer, which is a reseller of gas and closer to the ultimate market than Tennessee and Midwestern, shared in the risk of market fluctuations.

Based on these agreements, Tennessee and Midwestern undertook the multi-million dollar investments necessary to meet those customers' requirements. Tennessee entered into supply contracts with producers which also contained minimum take-or-pay obligations, and Midwestern undertook minimum bill obligations to its suppliers. These bargained-for minimum commodity bill provisions, which have been in Tennessee's and Midwestern's contracts and tariffs from the inception of service to such customers, were found to be required by the public con-

venience and necessity when the service to the customer was first certificated and have time and time again in numerous rate proceedings been a part of the tariff provisions that were approved as just and reasonable under the standards of Sections 4 and 5 of the Natural Gas Act. The Commission's elimination of the minimum commodity bills penalizes pipelines, such as Tennessee and Midwestern, for that reliance and effects an after-the-fact change in the governing rules.

Furthermore, in support of this abrogation of these longstanding contracts, the Commission's basic thesis accepted by the court below involved generalized statements of the benefits of competition.[5] The Commission made no attempt to show "unequivocal public necessity" as required by this Court (App. A-81, A-100), nor did the court below require such a finding (App. A-18).

The D.C. Circuit's acceptance of the Commission's general assertions of the benefits of competition is squarely contrary to *FCC* v. *RCA Communications*, 346 U.S. 86, 94 (1953) where this Court rejected a like order based on the mere recitation, without thorough study, that competition may have beneficial effects.

Therefore, the petitions should be granted because the court below ignored longstanding decisions of this Court which require a finding of "unequivocal public

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[5]The Commission performed no studies to support its findings. The Commission relied for the most part on general comments submitted by partial requirements customers of interstate pipelines who supported the Commission's proposal (*see* e.g. App. A-88 n. 28).

necessity" before the private contracts at issue here can be abrogated.

II.

THE COURT BELOW ERRED IN AFFIRMING A RULE WHICH RESTRUCTURED THE NATURAL GAS INDUSTRY BUT FAILED TO RESOLVE THE LINKED IMPACT OF ITS ACTIONS ON TAKE-OR-PAY

As the court below recognized, the Commission cannot issue a rule such as this without also resolving inextricably linked issues (App. A-38). Where the court erred, though, was in not recognizing that take-or-pay provisions between producers and interstate pipelines are inextricably linked with minimum commodity bills that exist between interstate pipelines and their customers.

It is clear that, in reliance on their sales contracts which contained minimum commodity bills recovering variable costs, pipelines in turn contracted for gas supplies from producers. These supply contracts typically include take-or-pay provisions which are similar in nature to the minimum commodity bills that were the subject of the Commission's rule. While it could not be disputed below that the same policy considerations could support elimination of these counterpart take-or-pay and minimum bill provisions alike, the court, as did the agency below, refused to require concurrent resolution of these inextricably related matters (App. A. 39-40). In thus failing to come to grips with the pipeline's take-or-pay obligations at the supply end of the pipeline system while eliminating the counterpart purchase obligations owing to

the pipeline at the opposite end of the pipeline system, the pipeline has been arbitrarily stripped of its right to contract with its purchasers in a way that corresponds with its purchase obligations to its suppliers.

If a more competitive marketplace is the *raison d'etre* below, then it must be recognized that in a truly competitive marketplace a customer could not expect its pipeline supplier to undertake massive gas supply commitments when, on the other hand, it could be relieved of its corresponding purchase obligations to the pipeline. Ironically, only regulation would have it so. But regulation must be a two way street, and the pipeline must likewise be relieved of its corresponding purchase obligations.

This lack of evenhanded treatment of these mutual, balanced seller-purchaser relationships which coexist at each end of the pipeline results in additional costs being borne by the pipeline and by its full requirements customers that have no alternative sources of supply. Thus, the take-or-pay and minimum commodity bill issues are inextricably linked as demonstrated by the substantial take-or-pay cost consequences that result if variable costs are not recovered in minimum commodity bills.

Review by this Court is therefore warranted because of the failure by the court below to recognize the inextricable link between take-or-pay and the recovery of variable costs in minimum commodity bills and to therefore, require the Commission to resolve the take-or-pay issue concurrently with the minimum bill issue.

CONCLUSION

For the reasons set forth above, this Court should issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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By_____

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February 10, 1986

Supreme Court, U.S.
FILED
FEB 13 1986
CLERK

Nos. 85-1219 & 85-1252

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

ARKLA ENERGY RESOURCES,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENT TEXAS GAS TRANSMISSION CORPORATION IN SUPPORT OF THE PETITIONERS

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QUESTION PRESENTED

Whether section 5 of the Natural Gas Act permits the Federal Energy Regulatory Commission to revoke or modify longstanding certificates of public convenience and necessity, issued under section 7 of the Act, by forbidding enforcement of contractual provisions for minimum commodity bills or minimum purchase obligations that are incorporated in those certificates.*

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* The parent companies and affiliates of respondent Texas Gas Transmission Corporation are listed in Appendix A, *infra*.

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15 U.S.C. § 717d	*passim*
15 U.S.C. § 717f	*passim*

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1219

TRANSWESTERN PIPELINE COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

No. 85-1252

ARKLA ENERGY RESOURCES,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENT TEXAS GAS TRANSMISSION CORPORATION IN SUPPORT OF THE PETITIONERS

STATEMENT

Respondent Texas Gas Transmission Corporation ("Texas Gas") operates an interstate pipeline for the transportation of natural gas under certificates of public convenience and necessity issued by the Federal Energy

Regulatory Commission ("FERC") and its predecessor, the Federal Power Commission ("FPC"), pursuant to section 7 of the Natural Gas Act of 1938 ("NGA"), 15 U.S.C. § 717f. The certificates at issue in this case make express reference to and incorporate specific contracts with provisions for minimum commodity bills that assure Texas Gas a minimum volume of sales. R. 496.[1] This assurance was a fundamental condition of Texas Gas's application for and acceptance of the certificates. R. 494, 1123.

In the administrative proceeding below, the FERC determined that all minimum commodity bills, even including those incorporated in a pipeline company's certificated authority, are "unjust" and "unreasonable" within the meaning of section 5 of the NGA, 15 U.S.C. § 717d. This determination will have a particularly adverse effect on Texas Gas. Approximately one-half of Texas Gas's total sales are made pursuant to contracts with "partial requirements" customers that have many alternative sources of supply. R. 493-96. Because these customers are located at the terminus of Texas Gas's interstate pipeline system, the preponderance of Texas Gas's investment in pipeline facilities necessarily was incurred to render service under these contracts. R. 484-85. Before the FERC ruled, these contracts prescribed roughly symmetrical obligations: Texas Gas had a firm obligation to deliver up to 100 percent of the contract amount, and the purchaser had a stated minimum obligation to buy at least 75 percent of that amount. The FERC's order destroys this symmetry. Without the assurance of minimum sales volumes to these customers, "50% of [Texas Gas's] market can swing from zero to 100% of contract demand." R. 496.

The FERC's order therefore goes to the very core of the nature of Texas Gas's contractual undertakings. Whereas Texas Gas previously was a supplier of baseload

[1] "R." refers to the joint appendix in the court of appeals.

service, its partial requirements customers now may unilaterally relegate it to the role of a supplier of peaking service only. The agency historically has recognized a clear distinction between baseload and peaking service:

> A pipeline would not normally be built to supply peak service, that is to say, service on the peak days only. . . . [P]ipelines are built to supply service not only on the few peak days but on all days throughout the year. In proving the economic feasibility of the project in certificate proceedings, reliance is placed upon the annual as well as the peak deliveries. Stated another way, the capital outlay for the pipeline facility is made—and justified—not only for service on the peak days but for service throughout the year.

Atlantic Seaboard Corp., 11 FPC 43, 54 (1952). The differences between baseload and peaking service affect not only the design of and investment in the pipeline but also the nature of the gas purchase contracts entered into by the pipeline to support such service. *See* Pet. 9 n. 9 (No. 85-1252).

Texas Gas's sudden demotion from a baseload to a peaking service supplier makes rational planning impossible and has serious economic implications. As a result of the FERC's order the majority of Texas Gas's partial requirements customers have reduced their purchases to levels far below the 75 percent minimum required by contract. This puts Texas Gas on the horns of a dilemma. Either Texas Gas must arrange for a decrease in the volumes it is committed to purchase under its supply contracts, thereby subjecting its full requirements customers to the likely curtailment of deliveries in the event that they demand full contract quantities; or Texas Gas must continue in force its existing contracts with producers and face the risk of very substantial liability resulting from its inability to purchase at the minimum levels required by the take-or-pay provisions

in such contracts, costs which may be borne by its full requirements customers. R. 495-96.[2] If Texas Gas had known that it was being certified to perform a service which its partial requirements customers could convert unilaterally to peaking only, or that its certificate was subject to modification to that effect, it would not have accepted the certificate and would not have made the substantial investment that was required in order to construct its pipeline and to perform its certificated base-load service. R. 1123. After making this investment and after entering long-term contracts for the supplies necessary to provide this service, Texas Gas has had its market unfairly and unexpectedly truncated by regulatory fiat.

There is no countervailing public benefit. Texas Gas is a low-cost supplier. R. 1109. But its partial requirements customers are other interstate pipelines that also acquire natural gas directly from producers. As a direct consequence of the FERC's order, "lower-cost purchases from Texas Gas have been cut back as a result of a pipeline customer's attempt to meet its take-or-pay minimums for higher cost producer supplies." R. 1110. The FERC's order, in other words, has the irrational result, at least in Texas Gas's instance, of diverting purchases from low-cost to high-cost supliers.

On petition for reivew before the court of appeals, Texas Gas contended that the FERC's order constituted an impermissible revocation or modification of its certificated authority. The court brushed this contention aside in a footnote:

> Section 7, which vests in the Commission control over the conditions under which gas may initially be dedicated to public use, does not guarantee that the

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[2] Take-or-pay provisions in contracts with producers, even though they are the functional equivalent of pipelines' minimum commodity bills, are not affected by the FERC's order. Pet. App. A-37 to A-40 (No. 85-1219).

> initial terms of that service will never change. *See* Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 389 (1959). Even assuming *arguendo* that the Commission has no authority to amend or revoke certificated service in a section 5 proceeding, the elimination of minimum bills has no affect on the pipeline's *authorized* service. The Order merely addresses the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5.

Pet. App. A-25 n.9 (No. 85-1219) (emphasis in original).

ARGUMENT

By permitting the effective revocation or modification of certificated authority, the decision below establishes an unfortunate precedent that will discourage pipeline companies and their investors from undertaking certificated service in the future. The decision misconstrues the proper relationship between sections 5 and 7 of the NGA and is inconsistent in principle with *United States v. Seatrain Lines, Inc.*, 329 U.S. 424 (1947). The Court should grant certiorari to review this important case.

1. Natural gas pipelines are very expensive and highly capital-intensive undertakings. Once constructed, the physcal equipment—the pipeline itself—cannot be converted to other uses. Interstate pipelines are not built on speculation. They are built to service identified markets and customers in accordance with specific long-term contractual arrangements. They are built and operated, moreover, in accordance with certificates of public convenience and necessity, issued by the FERC pursuant to section 7 of the NGA, that confirm the nature and scope of the service to be performed.

In applying for a certificate, a pipeline company is required to specify the essential elements of the service it is willing to perform, and its decision to accept a certificate depends upon receipt of authority to perform those essential elements of service. Thus, a company

which specifies that it is applying for authority to perform baseload service may refuse to accept a certificate that would give its customers the unilateral option of converting to peaking service. In this way, the company can be assured at the outset that the nature and scope of the service to be performed will support the required level of investment in facilities, personnel, and long-term purchase commitments.

If the pipeline company's certificated authority were subject to involuntary revocation or modification by the FERC, the necessary degree of assurance would be lacking:

> massive investments must be and are made to construct facilities in reliance on the conditions and permanence for the prescribed term of the certificates issued by the Commission. Without such security, businessmen and investment institutions would not enter into such projects nor lend the necessary funds to make the projects possible.

Trunkline LNG Co., 22 FERC ¶ 63,028 at 65,138, *aff'd*, 22 FERC ¶ 61,245 (1983). It has long been understood that the NGA provides the necessary assurance to pipeline companies and investors. Section 7, which governs the issuance of certificates, makes no provision for revocation or modification by the FERC except upon the request of the carrier itself. Almost forty years ago this Court held in *Seatrain Lines*, 329 U.S. at 429-32, that a certificate of public convenience and necessity may not be modified or revoked in the absence of express statutory authority. *See also CAB v. Delta Air Lines*, 367 U.S. 316, 321-25 (1961). Congress, in order to induce and protect investments in interstate pipelines, has never amended the NGA to provide such authority.

The decision below radically alters the statutory scheme. It permits the FERC, in the guise of exercising control over the justness and reasonableness of rates under section 5 of the NGA, actually to revoke or modify the essential elements of service incorporated in a certifi-

cate. The FERC's exercise of this novel power in this case unfairly defeats the settled expectations of pipeline companies and investors and introduces a damaging element of uncertainty into all future interstate pipeline undertakings.

Further, the FERC's order defeats the regulatory objective of reliable service. A hallmark of the NGA is its requirement that service be provided not at the lowest rate possible but at the lowest rate "consistent with the maintenance of adequate service in the public interest". *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388 (1959). By granting partial requirements customers the unilateral option of swinging from baseload service to peaking service, the FERC has impaired the ability of pipeline companies to maintain adequate service. In the absence of assurance that purchases will be maintained at a minimum level, it is impossible for a company to determine from year to year what level of service its partial requirements customers will demand. R. 475-79, 496. Accordingly, pipeline companies are placed in a position of having either inadequate supplies under contract, with consequent curtailment of service to all customers, or a surplus of supply, with attendant take-or-pay costs borne by full requirements customers.

2. The court of appeals justified this result on the ground that minimum commodity bills and minimum take provisions are "rates" that the FERC can change under section 5 even when they are incorporated in a pipeline company's certificated authority. But minimum commodity bills and minimum take provisions are not "rates." By defining the service obligation by reference to a minimum volume of natural gas, such provisions go to the essential nature of the service—baseload rather than peaking—and not merely to the price at which that service will be furnished. If the FERC had confined its attention simply to "rates," Texas Gas, as a low-cost supplier, would have had no complaint. The heart of

the problem is that the FERC has relieved Texas Gas's customers of their obligation to pay for a minimum volume of gas at any price.

To be sure, section 5 gives the FERC authority not only over "rates" but also over any "charge, classification, rule, regulation, practice or contract." Those very general statutory terms could be construed to cover each and every feature of certificated authority. But to construe section 5 expansively, as the court below has done, would allow the FERC to invalidate in its entirety a contract that defined the scope of certificated authority and thereby completely destroy the integrity of the certificate issued under section 7.

By omitting any provision for involuntary revocation or modification in section 7, Congress clearly evidenced its intention to protect the pipeline company against this type of involuntary and fundamental change in the nature and scope of its certificated service. The court below seriously erred in construing section 5 in a manner that fails to harmonize with the objectives of section 7. Section 5 should not be read to authorize involuntary changes in essential elements of certificated service.

CONCLUSION

The petitions for writs of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

Texas Gas Transmission Corporation is wholly owned by Texas Gas Resources Corporation, which in turn is wholly owned by CSX Corporation.

CSX Corporation owns partial interests in the following subsidiaries:

Atlanta and West Point Railroad Company
The Baltimore and Ohio Railroad Company
The Baltimore and Philadelphia Railroad Company
Chicago South Shore and South Bend Railroad
The Cleveland Terminal and Valley Railroad Company
Dayton and Michigan Railroad Company
Dayton and Union Railroad Company
Eastern Hardwoods, Inc.
Fruit Growers Express Company
James Center Development Company
Littleton Fuel Company
Louisville, Henderson & St. Louis Railway Company
Mid Allegheny Corporaton
Monon Coal Company, Inc.
Nashville & Decatur Railroad Company
New Ganly Coal Corporation
North Charleston Terminal Company
Richmond, Fredericksburg and Potomac Railroad Company
Richmond-Washington Company

Neither Texas Gas Transmission Corporation nor Texas Gas Resources Corporation owns a partial interest in any subsidiary.

Supreme Court, U.S.
FILED
MAR 24 1986
JOSEPH F. SPANIOL, JR.
CLERK

(5) (2) (2) (2) (3)

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF FOR RESPONDENT NORTHERN ILLINOIS GAS COMPANY IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

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28 pp

QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (the "Commission") has authority under the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982), to regulate and modify the rates charged by natural gas pipelines under minimum commodity bill provisions included in tariffs on file with the Commission.
2. Whether the court of appeals acted correctly in upholding the decision of the Commission to order the elimination of all variable costs from the rates charged under minimum commodity bills.
3. Whether the Commission may modify the rate provisions of tariffs on file with it on the basis of a record compiled in an informal rulemaking proceeding.

STATEMENT PURSUANT TO RULE 28.1

Northern Illinois Gas Company is a subsidiary of NICOR Inc., a publicly-held company. NICOR Inc. is not affiliated with any companies other than its wholly-owned subsidiaries.

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BRIEF FOR RESPONDENT NORTHERN ILLINOIS GAS COMPANY IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the court of appeals is reported at 770 F.2d 1144 and appears at Pet. App. A-1.[1] The court of appeals' orders denying rehearing and re-

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[1] References to "Pet. App. ——" appearing herein are to the Appendix to the Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit filed January 21, 1986 in Transwestern Pipeline Co. v. Federal Energy Regulatory Commission, No. 85-1219.

hearing *en banc*, are not officially reported and appear at Pet. App. A-57 and A-69, respectively. The orders of the Federal Energy Regulatory Commission (the "Commission") were issued in Docket No. RM83-71-000 and are identified as Order Nos. 380 (Pet. App. A-71), 380-A (Pet. App. A-129), 380-B (Pet. App. A-226), 380-C (Pet. App. A-231) and 380-D (Pet. App. A-271).

JURISDICTION

The decision of the court of appeals and its judgment in this case were entered August 20, 1985. A timely petition for rehearing and a suggestion for rehearing *en banc* were denied on October 25, 1985. This Court has jurisdiction to review the decision below pursuant to 15 U.S.C. § 717r(b) and 28 U.S.C. § 1254(1).

STATEMENT

1. Under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717w(1982), sales of natural gas for resale by interstate pipelines are subject to the comprehensive jurisdiction of the Commission. No such sales can take place unless the Commission has issued a certificate of public convenience and necessity under Section 7 of the NGA. 15 U.S.C. § 717f(1982). Once the service is commenced, Section 4(a) of the NGA provides that the rates and charges are "subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." 15 U.S.C. § 717c(a) (1982). Under Section 5(a) of the NGA, if the Commission finds that "any rate, charge, or classifi-

cation. . . . or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential," the Commission may fix by order the "just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed, and in force. . . ." 15 U.S.C. § 717d(a) (1982).

Generally, an interstate pipeline will have entered into a contract with each resale customer requiring the pipeline to provide, upon request on any given day, a maximum quantity of natural gas (the "daily contract quantity"). The rates for services to be charged under the contract will be contained in tariffs on file with and subject to the review of the Commission. To compensate the pipeline for the costs associated with providing gas sales service on demand, the tariff will require each customer to pay a monthly demand charge, based on the contract quantity, which recovers a portion of the fixed costs incurred by the pipeline in providing the service.[2] A customer must pay the demand charge, whether or not it actually requests or receives service during any billing period and irrespective of the level of service actually received. A customer also is required to pay a commodity charge based on the actual volume of gas purchased from the pipeline. The commodity charge is designed to recover the remaining portion of the pipeline's fixed costs and all variable costs, including purchased gas costs.

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[2] The exact portion depends upon the rate design used by the pipeline. The portions range from 25% to 70% of a pipeline's total fixed costs. Pet. App. A-76 n.14. *See generally* Columbia Gas Transmission Corp. v. F.E.R.C., 628 F.2d 578 (D.C. Cir. 1979).

In addition, some pipeline tariffs impose an additional charge, known as a minimum commodity bill. Minimum commodity bills require a customer to pay a charge for any shortfall in purchases below a specified level, ranging from 50% to 90% of the monthly or annual contract quantity, even though the customer does not actually purchase that quantity of gas.[3] Prior to the issuance of Order No. 380, most minimum bill charges were set at the level of the pipeline's commodity charge, including purchased gas costs. Thus, a pipeline customer purchasing only at the pipeline minimum bill level could never replace a unit of those purchases with alternate, less expensive supplies because the true cost of that unit, which would include the pipeline minimum bill charge, could never be less than the pipeline commodity price. Minimum commodity bills therefore established an effective floor on purchases by a customer from its supplying pipeline and placed a substantial restraint on the forces of competition.

2. In August 1983, the Commission issued a Notice of Proposed Rulemaking in which it proposed to remove all variable costs, including the cost of purchased gas, from the rates charged under minimum commodity bills. It noted that variable costs are not incurred when a pipeline does not make sales and therefore tentatively concluded that current minimum bills might allow pipelines to recover a "windfall." It also concluded that minimum commodity

[3] The monthly quantity generally equals the daily contract quantity times the number of days in the applicable month. If a customer's entitlement to firm sales volumes is less than the daily contract quantity times the days in the applicable period, the percentage requirement of the minimum commodity bill usually is applied to that lower volume.

bills served as barriers to competition by preventing pipeline customers from purchasing less expensive sources of supply. After receiving an initial round of comments, the Commission allowed interested parties to file reply comments.

Thereafter, the Commission promulgated Order No. 380, based on its findings that minimum commodity bills recovered costs that were not actually incurred, Pet. App. A-82 to A-85, and, further, were "anticompetitive." Pet. App. A-85 to A-92. To implement these conclusions, the Commission promulgated a new section to its regulations, 18 C.F.R. § 154.111, effective August 30, 1984, which required all costs of purchased gas to be excluded from the rate charged when customers did not purchase gas at full minimum bill levels. Pet. App. A-123 to A-124.[4] All other variable costs were required to be eliminated from the minimum commodity bill when each pipeline made its next general rate filing under Section 4 of the NGA. *Ibid.* The Commission declined to adopt the suggestion of some parties that minimum commodity bills be eliminated in their entirety or be applied to a lesser percentage of contract quantity. Pet. App. A-114 to A-115. It therefore left intact the volumetric level of minimum commodity bills and the fixed cost portion of the rates charged thereunder.

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[4] The Commission also applied this provision to "minimum take provisions," which require customers physically to receive a specified amount of gas. The court of appeals upheld the Commission's decision to apply 18 C.F.R. § 154.111 to both minimum bill and minimum take provisions, holding that "there is no difference between the two types of clauses with respect to the Commission's rationale for the rule. . ." Pet. App. A-35 n.18.

The Commission's decision to leave intact the fixed cost portion of the rate charged under minimum commodity bills has several effects. First, it provides affected pipelines with continued assurances of recovery of the fixed costs contained in their commodity charges. Pet. App. A-22, A-138, A-143. Thus, pipelines will continue to have a full and fair opportunity to recover all costs actually incurred in meeting their contractual obligations to their customers.

Second, by retaining the pre-existing floor on the contribution to fixed cost recovery by each customer (*i.e.*, the demand charge plus commodity fixed costs for volumes up to the minimum bill level), the Commission's rule protects pipeline customers against the full impact of cost-shifting if purchase levels shift in response to Order No. 380.

Third, the scope of the Commission's action limits its competitive impact. Rather than exposing pipelines to the full brunt of gas-on-gas competition, the orders leave pipelines with a partial shield against competition. Under the rule, a pipeline's sales to a customer will drop below the minimum commodity bill level in response to competition only if the rates of competitors are lower than the pipeline's rates by an amount greater than the fixed costs contained in the pipeline's commodity charge. Even if that condition is met and a pipeline actually loses sales, the pipeline will remain shielded from the full financial impact of that competition because it will continue to recover those fixed costs.

Fourth, to the extent that sales are lost and take-or-pay liability results,[5] the Commission left undis-

[5] Under certain gas purchase contracts, a purchaser must take a specified amount of gas, or pay for that amount even if not taken. Pet. App. A-20 to A-21.

turbed those provisions of its regulations which allow a pipeline to recover the carrying-costs associated with take-or-pay liability. Pet. App. A-105 n.47. It also invited pipelines to file proposals to target those costs on specific customers if such proposals could be justified. Pet. App. A-106.

3. After petitions for rehearing were denied by the Commission, several parties petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the Commission's orders, pursuant to 15 U.S.C. § 717r(b) (1982). The court of appeals affirmed the Commission, holding that the Commission had the statutory authority to issue the rule, because "Sections 4 and 5 of the Natural Gas Act empower the Commission to regulate rates, charges, and practices of natural gas companies under its jurisdiction." Pet. App. A-24 to A-25. The court of appeals also concluded that "[t]he Commission has provided abundant evidence that the recovery of variable costs through minimum bill and minimum take clauses prevents customers from shopping for low-cost gas, thereby insulating pipelines from market forces that would otherwise drive gas prices down." Pet. App. A-36. The court of appeals, after review of the record, then determined that "the Commission adequately addressed the concerns of captive customers," Pet. App. A-42, that "each of the order's essential elements is supported by substantial evidence," *ibid.*, and therefore that it was not its "province 'to supplant the Commission's balance of these interests with one more nearly to [our] liking.' *Permian Basin*, 390 U.S. at 792." *Ibid.* The court of appeals also held that the Commission was authorized to promulgate the rule after informal notice

and comment rulemaking because "the decision whether to proceed by rulemaking or adjudication lies within the broad discretion of the agency," Pet. App. A-51, and "the 'substantial evidence' provision in the Natural Gas Act does not affect the *procedure* the Commission is required to follow." Pet. App. A-54 (emphasis in original).

4. Northern Illinois Gas Company ("NI-Gas"), a respondent in this case, is a local distribution company engaged in the sale and distribution of natural gas to over 1,500,000 customers in northern Illinois. Historically, NI-Gas has purchased close to 100% of its supply from interstate pipelines, three of which have minimum commodity bills in the tariffs applicable to NI-Gas. Because these minimum commodity bills had increased the cost of gas to the consumers served by NI-Gas, NI-Gas actively supported the proposed rule and defended the final rule before the court of appeals. At the time the Commission was receiving comments in the rulemaking that resulted in Order No. 380, NI-Gas estimated that its consumers would save tens of millions of dollars per year as a direct result of the additional flexibility to substitute lower priced sources of gas for higher priced gas which NI-Gas previously had been forced to purchase. Because the rule increases NI-Gas' options for buying gas and the competition among pipelines and other sources of gas, NI-Gas anticipates that the combined impact of its increased flexibility and increased industry-wide competition will result in rates charged to its consumers that are tens of millions of dollars below the level which would prevail absent Order No. 380.

REASONS FOR DENYING THE PETITIONS

The unanimous decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. The court of appeals properly applied well-established standards for review of Commission action. After careful consideration of the record below, the court of appeals determined that the Commission's findings were supported by substantial evidence and that the Commission's actions were within its substantive authority and in accord with appropriate procedural safeguards. Petitioners' challenges to the decisions of the court of appeals and the Commission boil down to dissatisfaction with the application of settled legal principles to the facts of this particular record, and do not merit review by this Court.

I.

The decision below evidences no confusion as to the appropriate standards of review. It applies longstanding principles of judicial review of agency action in a carefully reasoned opinion. Having properly articulated these standards, the decision then applies them to a voluminous record, and determines that the actions of the Commission satisfy those standards. Thus, while the rule promulgated by the Commission might have broad impact, the review afforded by the court of appeals was sufficient to dispose of all of petitioners' contentions.

This Court has defined the responsibilities of a court reviewing agency actions taken under the NGA in the following terms:

> First, it must determine whether the Commissioner's order, viewed in light of the relevant

> facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests. . . . The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly of its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.

Permian Basin Area Rate Cases, 390 U.S. 747, 791-792 (1968). As described more fully in Parts II and III of this brief, the court of appeals properly applied each of these standards in reviewing the actions of the Commission. First, the court of appeals considered whether the actions of the Commission were within its substantive authority under the NGA and properly concluded that they were. Second, the court of appeals reviewed the record and determined that each of the essential elements of Order No. 380 was fully supported by substantial evidence. Third, the court of appeals determined that Order No. 380 adequately protected investors by maintaining the fixed cost portion of minimum commodity bills and providing a fair opportunity for pipelines to recover all prudently incurred costs.

Thus, the present case involves a routine review of administrative action under well-established legal

principles. As this Court has made clear, the responsibility for assessing a record to determine whether agency findings are supported by substantial evidence "is not ours," but that of the "courts of appeals." "This Court will intervene only in what ought to be the rare instance where the standard appears to have been misapprehended or grossly misapplied." *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283, 309-310 (1974).

II.

The court of appeals concluded that the Commission had explicit statutory authority to take the actions herein challenged. Pet. App. A-25. Section 5(a) of the NGA, 15 U.S.C. § 717d(a) (1982), states that if the Commission "find[s] that any rate, charge. . . . or any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable," the Commission shall fix by order "the just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed. . ." Minimum commodity bills establish the "just and reasonable rate" to be paid by a pipeline customer when it fails to achieve a contractually agreed-upon level of purchases. Pet. App. A-25 n.9. The Commission's rule did not alter those levels or a customer's obligation to compensate a pipeline for the prudently incurred costs of providing service. The orders merely concluded that a rate for shortfalls of purchases below a pipeline's minimum bill level *which recovers costs not actually incurred* is "unjust [and] unreasonable" within the meaning of Section 5 of the NGA, 15 U.S.C. § 717d(1982), and therefore prohibited that practice on a prospective basis. Such regulation of rates and charges is precisely the au-

thority granted the Commission by Section 5 of the NGA.[6]

Petitioners' efforts to portray the Commission actions as a prohibited alteration of certificates were properly rejected by the court of appeals, Pet. App. A-25 n.9,[7] and petitioners' reliance on cases such as *United States v. Seatrain Lines, Inc.*, 329 U.S. 424 (1947), is misplaced. A certificate of public convenience and necessity issued under Section 7 of the NGA confers upon the recipient the right and obligation to provide a specific service. Absent a certificate, a party is prohibited from providing the specified service. However, the determination of the just and reasonable rate level for a particular service, which must recognize the financial interests of the pipeline, is a far different matter from revoking a pipeline's right to provide that service. The orders of the Commission, which operate on a prospective basis only, leave intact the service rights and obligations of pipelines, including each customer's obligation to com-

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[6] Petitioners' reliance on United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956), and F.P.C. v. Sierra Pacific Power Co., 350 U.S. 348 (1956), is entirely misplaced. *E.g.*, No. 85-1219 Pet. at 8-11. Those cases deal only with the burden of proof and do not question the Commission's substantive ratemaking authority under Section 5 of the NGA when adequate findings are made by the Commission.

[7] The court of appeals also properly concluded that a certificate confers no guarantee that the initial terms of an approved service will not be changed, citing Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 389 (1959). Upon appropriate showings, "the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." Permian Basin Area Rate Cases, *supra*, 390 U.S. at 783-84.

pensate the pipelines, and the orders deal solely with the rates charged for one element of service. Thus, *Seatrain*, even if read as broadly as petitioners contend, is not relevant to the present case.

III.

Petitioners, in various guises, also argue that the Commission's rule "abrogates" contracts, destroys the "mutuality" of contracts, or denies pipelines the constitutionally-mandated fair opportunity to recover their costs. *E.g.*, No. 85-1250 Pet. at 9-10; No. 85-1236 Pet. at 9; No. 85-1237 Pet. at 10. As the court of appeals properly concluded, these arguments are devoid of merit. Pet. App. A-25 n. 9.

Under Order No. 380, pipeline customers remain obligated to pay a demand charge to compensate their supplying pipelines for standing ready to provide service up to the daily contract quantity specified in the contracts. Customers remain obligated to pay commodity charges for actual purchases and fixed costs for any minimum bill deficiency volumes. Simply put, pipeline customers remain obligated to compensate pipelines for costs prudently incurred to provide the contracted-for service, preserving mutuality between the providers and recipients of gas sales services. All the Commission did, by invoking its authority under Section 5 of the NGA, was to hold that it is "unjust [and] unreasonable" for a pipeline *to charge customers for costs which it has not incurred.*

This decision by the Commission is clearly within the power granted by the NGA and its finding that the previous rate structure for minimum commodity bill charges is unjust and unreasonable fully satisfies the requirements established by the Court in the *Mobile-Sierra* doctrine. The *Mobile-Sierra* line of

cases recognizes the primary role played by contracts under the NGA. It does not, however, prohibit the Commission from exercising its powers under Section 5 of the NGA to prescribe just and reasonable rates. The ability of the Commission to modify contractually specified rates is beyond peradventure. "The basic power of the Commission is that given it by § 5(a) to set aside and modify any rate or contract which it determines after hearing, to be 'unjust, unreasonable, unduly discriminatory, or preferential'." *United Gas Pipe Line Co. v. Mobile Gas Service Corp., supra*, 350 U.S. at 341. *See also F.P.C. v. Louisiana Power and Light Co.*, 406 U.S. 621, 646-47 (1972).

The finding of the Commission that minimum bill charges which recover unincurred costs are unjust and unreasonable cannot be characterized as arbitrary or capricious. The two essential elements of the Commission's findings, that minimum bills authorize the recovery of unincurred costs and inhibit competition, are uncontroverted. Petitioners do not dispute the conclusion of the Commission that purchased gas costs are not incurred. At most, they argue that other costs, primarily take-or-pay costs which may be claimed by producers under gas purchase contracts, may be incurred if the orders remain in effect. They further argue that while minimum commodity bills admittedly restrain competition, such bills provide pipelines with both the constitutionally-protected fair opportunity to recover their prudently-incurred costs and the additional right to retain a fixed market share, irrespective of any other factors, citing *United States v. El Paso Natural Gas Company*, 376 U.S. 651, 659-660 (1964).

However, this claim misstates the law and the impact of the Commission rule. While minimum commodity bills have been justified for several reasons,[8] an absolute grant of immunity from competition is not one of those reasons. The Commission may promote competition to better serve the public interest.[9] The sole issue is whether its actions properly recognize the financial interests of pipelines and fairly compensate investors. *Permian Basin Area Rate Cases, supra,* 390 U.S. at 790-91; *F.P.C. v. Natural Gas Pipeline Co.,* 315 U.S. 575 (1942); *Lynchburg Gas Co. v. F.P.C., supra,* 336 F.2d at 949-50 (Washington, J., concurring).

The Commission's rule, as found by the court of appeals, strikes a reasonable balance between effective competition and the expectations of investors in a manner consistent with the requirements established by this Court. The final Commission rule provides each affected pipeline with a full and fair opportunity to recover its cost of service, including the costs associated with any increased take-or-pay liability. Demand charges, which recover a significant portion of pipeline fixed costs, are unaffected by the rule. The fixed costs recovered through the pipeline's commodity charge are also unaffected because the

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[8] *See generally* Mississippi River Transmission Corp. v. F.E.R.C., 759 F.2d 945 (D.C. Cir. 1985); Atlantic Seaboard Corp. v. F.P.C., 404 F.2d 1268 (D.C. Cir. 1968); Lynchburg Gas Co. v. F.P.C., 336 F.2d 942 (D.C. Cir. 1964). Both the Commission and the court of appeals concluded that Order No. 380 satisfied the standards set forth in those cases.

[9] *See generally* Otter Tail Power Co. v. United States, 410 U.S. 366 (1973); Atlantic Seaboard Corp. v. F.P.C., *supra,* 404 F.2d at 1272; Northern Natural Gas Co. v. F.P.C., 399 F.2d 953, 964-65 (D.C. Cir. 1968).

minimum commodity bills continue in effect, at pre-existing levels, for such fixed costs. Only variable costs, which by definition are *not* incurred when purchases are not made, are excluded from recovery through the minimum bill charge.

Petitioners argue, however, that these unincurred variable costs are a proxy for take-or-pay costs which are an inevitable result of Order No. 380. This argument overlooks the fact that if a pipeline loses sales due to the rule and therefore incurs take-or-pay liability to producers, those costs may be reflected in its rates. Such payments, if prudently incurred, are placed in the pipeline's rate base and the pipeline may recover in its rates the carrying costs associated with that rate base account. Pet.App. A-105 n. 47. Thus, the pipeline receives a full and fair opportunity to recover its costs. The consumers' interests are therefore balanced with the pipeline's financial health. *Cf.*, *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 792; *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Arguments that the Commission's rule creates a new market structure or results in confiscatory rate structures are completely without merit.

Certain petitioners also argue that the rule is arbitrary because it will foster cost-shifting among customers. *E.g.*, No. 85-1236 Pet. at 11. But the continued availability of demand charges and fixed cost minimum commodity bills limits the potential for the shifting of fixed costs among customers. The sole potential for such cost-shifting arises if and when the pipeline reflects in its rates take-or-pay costs caused by the rule. To the extent any misallocation results, the Commission has invited pipelines to

propose allocations which properly assign such costs. Pet. App. A-106.

Thus, pipelines will continue to be fairly compensated for all costs prudently incurred in providing sales service up to the maximum contract quantities embodied in the service agreements. The financial obligations of pipeline customers remain tied to the same benchmarks. The Commission's rule merely seeks to promote competition by prohibiting pipelines from recovering costs which they themselves must acknowledge are not incurred.

IV.

The Commission adopted its rule after an informal notice and comment process, allowing for the filing of reply comments as well as the statutorily authorized petitions for rehearing. The court of appeals affirmed this use of informal rulemaking proceedings as consistent with the statutes, its precedents, and the decisions of this Court.

The statutes and precedents authorize the Commission to establish rates pursuant to rulemaking procedures.[10] Section 403(c), of the Department of Energy Organization Act, 42 U.S.C. § 7173(c) (1982) ("DOE Act"), states: "Any function. . . . which relates to the establishment of rates and charges under the. . . . Natural Gas Act, may be conducted by rulemaking procedures." Moreover, this Court has clearly sanctioned agency discretion in selecting its procedures:

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[10] Petitioners argue that, in promulgating the rule, the Commission was not exercising its ratemaking authority. No. 85-1219 Pet. at 22-25; No. 85-1252 Pet. at 10-12. We have responded to this argument on pp. 11-13, *supra*.

> Absent constitutional constraints or extremely compelling circumstances the "administrative agencies 'should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties'." *FCC v. Schreiber*, 381 U.S., at 290, 85 S. Ct. at 1467, quoting from *FCC v. Pottsville Broadcasting Co.*, 309 U.S., at 143, 60 S. Ct., at 441. Indeed, our cases could hardly be more explicit.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519, 543-44 (1978). An agency may choose to proceed through either adjudication or rulemaking proceedings, *SEC v. Chenery Corp.*, 332 U.S. 194, 201-03 (1947), and it must "be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties." *Permian Basin Area Rate Cases, supra*, 390 U.S. at 790. The statutory requirement of a hearing may be satisfied by written comments. *United States v. Florida East Coast Ry. Co.*, 410 U.S. 224, 241 (1973). Given the Court's decisions in *Vermont Yankee* and *Florida East Coast Ry.*, the courts of appeals in this case and others consistently have concluded that the Commission may proceed by rulemaking in carrying out its responsibilities under the NGA. *E.g.*, Pet. App. A-50 to A-56; *Phillips Petroleum Co. v. F.P.C.*, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974); *Tenneco Oil Co. v. F.E.R.C.*, 571 F.2d 834 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1979).

Petitioners nonetheless argue that *Florida East Coast Ry.* and *Vermont Yankee* prohibit the use of informal rulemaking procedures in this context because "disputed facts" were raised and the Commis-

sion was "making a 'quasi-judicial' determination by which a very small number of persons are 'exceptionally affected, in each case, upon individual grounds, . . .'" No. 85-1237 Pet. at 12, *citing Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., supra*, 435 U.S. at 542. This argument is meritless because the present case clearly raises "policy-type rules or standards" applicable to all competitors in a regulated industry.[11] The conclusion of the Commission that minimum commodity bills permit the recovery of unincurred costs cannot be disputed, nor can the conclusion that such minimum commodity bills adversely affect competition. And the balance to be struck between competition and other values under the NGA, within constitutional and statutory limits, is plainly a matter for industry-wide application. Indeed, any attempt to resolve these industry-wide issues on a case by case basis would have had significantly greater impact on individual pipelines.

Despite petitioners' attempt to fabricate new legal standards, the law requires only that substantial evidence support the essential elements of the Commis-

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[11] In its Order on Rehearing, the Commission specifically considered and addressed the arguments raised by the individual pipelines. Pet. App. E. This careful consideration of the individual circumstances of the pipelines satisfies any procedural rights due to them. Furthermore, while the Commission concluded that all minimum bills which recover variable costs are unjust and unreasonable, it also concluded that it would not eliminate fixed cost minimum bills on a generic basis. Pet. App. A-115. The Commission has continued to consider fixed cost minimum commodity bills on their individual merits. *E.g.*, Tennessee Gas Pipeline Co., 32 F.E.R.C. ¶ 61,311 (1985); Transwestern Pipeline Co., 32 F.E.R.C. ¶ 61,009 (1985).

sion's order. It must be stressed that, as well as ruling on the procedure followed by the Commission, the court of appeals specifically found that "each of the order's essential elements is supported by substantial evidence." Pet. App. A-42. The court of appeals found that the procedures adopted by the Commission produced an adequate record, specifically including substantial evidence to support each essential element of the Commission's decision. The capacity of procedures to produce substantial evidence, not the procedural method itself, is the relevant issue. As this Court has held, "Congress . . . . specified necessary components of the ultimate decision, but it did not specify the method by which the Commission should acquire information about these components." *United States v. Florida East Coast Ry. Co., supra,* 410 U.S. at 235.

The DOE Act specifically authorizes the use of rulemaking procedures in ratemaking matters. 42 U.S.C. § 7173(c) (1982). The court of appeals found that the essential elements of the Commission's decisions are supported by "substantial evidence", thereby satisfying the mandates of the NGA. Thus, the conclusion of the court of appeals that the "substantial evidence" standard of the NGA "does not dictate the procedure to be followed . . . . [but] has to do with a court's review of the adequacy *vel non* of the evidence relied upon to support a finding, whatever the kind of hearing," Pet. App. A-55 (citing *American Public Gas Association v. F.P.C.*, 567 F.2d 1016, 1067 (D.C. Cir. 1977)), was mandated by the decision of this Court in *Vermont Yankee*:

> [T]he adequacy of the "record" in this type of proceeding is not correlated directly to the type of procedural devices employed, but rather turns on whether the agency has followed the statutory

> mandate of the Administrative Procedure Act or other relevant statutes. . . In short, nothing in the APA, NEPA, the circumstances of this case, the nature of the issues being considered, past agency practice, or the statutory mandate under which the Commission operates permitted the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory *minima*, a matter about which there is no doubt in this case.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., supra, 435 U.S. at 547-48.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted,

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March 24, 1986

Supreme Court, U.S.
FILED
MAR 27 1986
JOSEPH F. SPANIOL, JR.
CLERK

(6) (3) (3) (3) (4)

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,
VS.
FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT SOUTHERN CALIFORNIA GAS COMPANY IN OPPOSITION TO PETITIONERS

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BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (Commission) has the authority under Section 5 of the Natural Gas Act to modify tariff provisions when the Commission finds that those tariff provisions have anti-competitive effects.

2. Whether the Commission's notice and comment procedures in a formal rulemaking proceeding satisfy the requirements of the Natural Gas Act.

3. Whether the Commission's finding that minimum commodity bill and minimum take provisions in tariffs have anti-competitive effects was supported by substantial evidence.

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Statute

Natural Gas Act, 15 U.S.C. §§ 717-717w (1982) . . *passim*

LIST OF PARENT, SUBSIDIARIES AND AFFILIATES

Southern California Gas Company (SoCalGas) is a wholly-owned subsidiary of Pacific Lighting Corporation. The following are the parent, subsidiaries and affiliates of SoCalGas:

Ankirk
Blackfield Hawaii Corporation
California LNG Company
Carmel Mountain Properties
Central Plants, Inc
Dual Fuel Systems, Inc.
Dunn Properties Corporation
Dunn Properties of Georgia, Inc.
Dunn Properties of Texas, Inc.
Fredericks Sales, Inc.
Fredricks Development Corporation
Fuel Industries New Zealand Limited
Hawaii Management Corporation
Mayflower Realty Associates, Inc.
Modular Products, Inc.
Nellie Gail Ranch Recreation Company
Pacific Alaska LNG Company
Pacific Center Downtown, Inc.
Pacific Energy Resources Incorporated
Pacific Gas Gathering Company
Pacific Geothermal Company
Pacific Hydropower Company
Pacific Indonesia LNG Company
Pacific Interstate Company
Pacific Interstate Mojave Company
Pacific Interstate Offshore Company
Pacific Interstate Transmission Company
Pacific Interstate Transmission Company (Arctic)

Pacific Lighting Bio-Energy Company
Pacific Lighting Capital Company N.V.
Pacific Lighting Commercial Loans, Inc.
Pacific Lighting Corporation
Pacific Lighting Energy Systems
Pacific Lighting Exploration Company
Pacific Lighting Gas Development (Canada) Ltd.
Pacific Lighting Gas Development Company
Pacific Lighting International Finance N.V.
Pacific Lighting Land Company
Pacific Lighting Leasing Company
Pacific Lighting Marine Company
Pacific Lighting Oil and Gas Company
Pacific Lighting Overseas Finance N.V.
Pacific Lighting Properties, Inc.
Pacific Lighting Real Estate Group
Pacific Lighting Securities Company
Pacific Offshore Pipeline Company
Pacific Oroville Power, Inc.
Pacific Synthetic Fuel Company
Presley ASW Finance Co., Inc.
Presley Chicago, Inc.
Presley Company East, Inc.
Presley Company of New Mexico
Presley Development Company of Arizona
Presley Financial Corporation
Presley-Home Mac Finance Co., Inc.
Presley of Northern California
Presley of San Diego
Presley of Southern California
Sabagli N.V.
S. M. Dunn, Inc.
SMA Development Corporation
Southern California Conservation Financing Company

Southern California Gas International Finance N.V.
Southern California Solar Financing Company
Terra Resources, Inc.
The Presley Companies
Western LNG Terminal Company
Western Power, Inc.

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

In the Supreme Court
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OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

VS.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT SOUTHERN CALIFORNIA GAS COMPANY IN OPPOSITION TO PETITIONERS

Respondent, Southern California Gas Company (SoCalGas),[1] respectfully requests that this Court deny the Petitions for Writ of Certiorari, seeking review of the District of Columbia Circuit Court of Appeals' opinion in this case. App. at 1.[2] This case involves no conflict between the Circuits, raises no Constitutional question, and

[1]SoCalGas and its affiliate, Pacific Lighting Gas Supply Company (PLGS), were parties below. Recently, SoCalGas and PLGS merged and are operating under the name of SoCalGas.

[2]The appendix references are to the appendix filed with this Court by Transwestern Pipeline Company.

involves no significant issue concerning the administration of the Natural Gas Act. 15 U.S.C. §§ 717-717w (1982).

STATEMENT OF THE CASE

This case involves the Federal Energy Regulatory Commission's (Commission) promulgation of a rule which eliminates non-incurred variable gas costs from the tariffs of interstate pipelines. Under the rule, the pipelines continue to collect, unchanged, the fixed costs in their tariffs. These fixed costs include the non-gas costs of a pipeline such as wages, operation and maintenance expenses, depreciation and return on rate base. The pipelines also continue to collect the gas costs which they incur for the gas they sell. However, pipelines can no longer bill and collect from their customers for gas costs which they do not incur.

The Commission has applied this rule to both minimum commodity bills and minimum take provisions. Minimum commodity bills require customers of pipelines to pay for minimum quantities of gas whether or not it is taken. Minimum take provisions are even more restrictive, requiring customers of pipelines to actually take a minimum quantity of gas whether or not they want it. Both of these minimum bill provisions severely restricted a customer's discretion in making purchases.

Six natural gas pipeline companies have filed Petitions with this Court to seek review of a unanimous decision of the Court of Appeals for the District of Columbia Circuit which affirmed the Commission's Orders in all respects, except one which is not a subject of these Petitions.[3]

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[3]Petitions have been filed by Transwestern Pipeline Company (Transwestern) (No. 85-1219); ANR Pipeline Company (ANR) (No. 85-1236); Texas Eastern Transmission Corporation (Texas Eastern)

Petitions for Rehearing were denied by the Court of Appeals, with no member requesting the taking of a vote on the Petitions. App. at 69, 70.

SoCalGas is a natural gas distribution company which provides natural gas service in southern and central California. SoCalGas is the largest natural gas distribution company in the country having more than 4.0 million customers and providing natural gas service to a population of approximately 13.0 million. SoCalGas purchases natural gas from a number of interstate pipeline companies including Transwestern Pipeline Company (Transwestern), one of the Petitioners before this Court.

Under the provisions in Transwestern's tariff, SoCalGas had the annual obligation to take or pay for 91 percent of a contract quantity of 750,000 Mcf of gas per day. Transwestern's tariff provisions also required that SoCalGas actually take from Transwestern, regardless of its need and regardless of the cost, on a daily basis, 80 percent of the contract quantity of 750,000 Mcf or 600,000 Mcf of gas. If SoCalGas did not need this volume of gas on a daily basis it was still required to take such volumes.

The Commission's Order Nos. 380, 380-A, 380-B, 380-C and 380-D[4] relieved SoCalGas of these severe tariff restrictions and allowed it to purchase gas based upon relative cost rather than these tariff provisions.[5]

(No. 85-1237); Trunkline Gas Company and Panhandle Eastern Pipeline Company (No. 85-1250); and Arkla Energy Resources (Arkla) (No. 85-1282).

[4]These orders are referred to in this brief as "Order No. 380."

[5]It should be noted that other provisions in Transwestern's tariff relieve Transwestern of the obligation to provide the contracted quantity of gas during periods when gas is unavailable. These tariff provisions which were placed in Transwestern's tariff long after Transwestern's contract was signed with SoCalGas were approved by

The Commission's intention of promoting competition among interstate pipelines in issuing Order No. 380 has had its desired effect. For example, Transwestern which at the time of the issuance of Order No. 380 was a higher priced supplier to SoCalGas, has, in response to competition generated by Order No. 380, become the low price leader of the suppliers to southern California.[6] As the result of discretionary actions which Transwestern has taken, it has significantly reduced its commodity rate to SoCalGas. The ratepayers of SoCalGas are the ultimate beneficiaries of this reduction.

REASONS WHY THE WRIT SHOULD BE DENIED

I

The Court's Decision Below Follows An Unbroken Line Of Authority In Finding That The Commission Acted Within Its Authority To Modify Tariffs And Contracts Under Section 5 Of The Natural Gas Act.

Petitioners here launch what the Court below termed a "barrage of attacks upon the Commission's authority to issue Order No. 380." App. at 25. The Commission's authority to act under Section 5 of the Natural Gas Act, 15 U.S.C. § 717d (1982), is so clear, and the arguments by

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the Commission and upheld by the Ninth Circuit Court of Appeals in *Pacific Lighting Service Co. v. FPC,* 518 F.2d 718 (9th Cir. 1975).

[6]Prior to the effective date of Order No. 380, Transwestern's commodity rate of $3.85/MMBtu was significantly higher than the $3.57/MMBtu commodity rate of El Paso Natural Gas Company (El Paso), which is Transwestern's major competitor in the southern California market. *Compare Transwestern Pipeline Co.*, 26 FERC ¶ 61,424 (1984) with *El Paso Natural Gas Co.*, 26 FERC ¶ 61,423 (1984). Currently Transwestern's commodity rate is $2.87/MMBtu compared to El Paso's current commodity rate of $2.98/MMBtu. *Compare Transwestern Pipeline Co.*, 34 FERC ¶ 61,201 (1986) with *El Paso Natural Gas Co.*, 34 FERC ¶ 61,171 (1986).

the Petitioners are so tenuous, that the Court below found that the Petitioners' claims concerning the Commission's authority to act were either "frivolous" or "completely without merit." App. at 25.

Simply put, an argument cannot credibly be made that the Commission exceeded its authority in issuing Order No. 380. Section 5 of the Natural Gas Act empowers the Commission upon finding "that any rate, charge, or classification . . . or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential" to determine the just and reasonable rate or contract and to fix that rate or contract by order. 15 U.S.C. § 717d(a). The Court below, in citing to this Court's decision in *Permian Basin Area Rate Cases*, 390 U.S. 747, 783-84 (1968), stated, "At any rate, Section 5 gives the Commission authority to alter terms of any existing contract found to be 'unjust' or 'unreasonable' ". App. at 25-26.

In fact, Petitioners acknowledge that the Commission is authorized under Section 5 of the Act to modify contracts and tariffs. *See* Transwestern's Petition at 9, Texas Eastern's Petition at 11. Petitioners cite no case which challenges the Commission's authority to modify tariffs or contracts. Instead, Petitioners argue that the Commission exceeded its authority because it did not fully consider the role of contracts under the Natural Gas Act or that the provisions of Order No. 380 destroy the mutuality of contracts. In essence, these arguments by Petitioners, while termed to be challenges to the statutory authority of the Commission to issue its Order, are in reality merely disagreements with the Commission's weighing of the various factors which were considered in issuing its decision. The role of this Court is not to weigh the individual factors in evidence but to defer to the

expertise of the administrative agency in considering the evidence before it. *Permian Basin,* 390 U.S. 747 (1968).

II

The Court's Decision Below Does Not Raise Certain Of The Questions Presented In The Petitions.

Petitioners have raised for review certain issues which were not the holding in the decision of the Court below. First, Petitioners question if the Commission is authorized to abrogate a settlement agreement which was previously approved by the Commission. Second, Petitioners question if the Commission is authorized to modify or revoke a certificate of public convenience and necessity issued under Section 7 of the Natural Gas Act, 15 U.S.C. § 717f (1982). The District of Columbia Circuit Court of Appeals either did not decide these issues or did not base its decision upon such finding. Moreover the facts below indicate there was no violation of a settlement or revocation of a certificate.

A Petitioner, ANR, contends that the Commission has exceeded its statutory authority by abrogating a settlement agreement to which the Commission was a party. The District of Columbia Circuit however did not decide this issue. The Court below stated, "We find that Order No. 380 does not violate any term of either Transco's or ANR's settlement. We therefore do not reach the issue of whether the Commission has the statutory authority to abrogate settlement agreements to which it is a party through a generic section 5 rulemaking." App. at 26.

Moreover, the record in this proceeding does not permit the formulation of a resolution of this question presented by the Petitioner. The underlying settlement merely provides that the minimum bill issue shall be set for hearing in Docket No. RP82-80. (ANR attachment I at

B-1). In discussing this settlement the Court below found that the Commission was not restricted in dealing with ANR's minimum bill in an ongoing rulemaking. The Court stated, "As it is written, however, the agreement neither binds the Commission to resolve the issues in ANR's ratemaking proceeding nor exempts ANR's minimum bill provisions from the general rulemaking in progress. We conclude, therefore, that by issuing Order No. 380 the Commission did not violate the terms of the settlement agreement." App. at 29.

Petitioners, Transwestern and Arkla, claim that the Commission was without authority to revoke or modify certificates of public convenience and necessity granted under Section 7 of the Natural Gas Act. 15 U.S.C. § 717f. While the Court found that the Commission did have the authority to modify certificates, its holding was not based upon this finding. The Court below, citing this Court's decision in *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 389 (1959), found that Section 7 of the Natural Gas Act does not guarantee a recipient of a certificate that the initial terms of the certificate will never be changed. The Commission has the authority under Section 5 of the Natural Gas Act, 15 U.S.C. § 717d, to alter and amend terms and conditions of certificated service. *Pacific Gas Transmission Co. v. FPC*, 536 F.2d 393 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 999 (1976). In fact, once the Commission determines a term or condition is unjust and unreasonable it must remedy the situation. *American Smelting and Refining Co. v. FPC*, 494 F.2d 925 (D.C. Cir. 1974), *cert. denied*, 419 U.S. 882 (1974); *Pacific Gas Transmission Co. v. FPC*, 536 F.2d 393 (D.C. Cir. 1976).

The decision of the Court below would not change even if its determination is incorrect since the Court found that the Commission's decision did not revoke or modify

the Section 7 certificates of Petitioners. The Court stated:

> Even assuming *arguendo* that the Commission has no authority to amend or revoke certificated service in a Section 5 proceeding, the elimination of minimum bills has no effect on the pipelines *authorized* service. The Order merely addresses the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to Section 5.

App. at p. 25, n.9 (emphasis in original). Thus, the issues which Petitioners have asked this Court to review are simply not material to the decision of the Court below.

III

As The Court Below Found, The Commission Utilized The Proper Procedures And Therefore There Is No Reason For This Court To Grant The Writ For Certiorari.

Petitioners argue that the rulemaking procedures used by the Commission in this case were insufficient to satisfy the hearing requirement of Section 5 of the Natural Gas Act. The statutory requirement for a hearing can be satisfied through either a rulemaking proceeding or an adjudicatory proceeding. *SEC v. Chenery Corp.*, 332 U.S. 194 (1947); *Phillips Petroleum Co. v. FPC*, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974). In this case, the Commission within its discretion, utilized its rulemaking procedures. The Court below found that the Commission's decision to proceed through rulemaking, "clearly passes muster under our deferential standard of review." App. at 51. *See, FPC v. Transcontinental Gas Pipeline Corp.*, 423 U.S. 326, 333 (1976).

The use of notice and comment procedures by the Commission was an appropriate method to acquire information on an industry-wide problem. *See, United States v.*

Florida East Coast Ry. Co., 410 U.S. 224, 245 (1973). The fact that 95 parties submitted over 1,000 pages of comments in response to the Commission's first notice of proposed rulemaking indicates that the Commission's proposed rulemaking was not a matter that uniquely or exceptionally affected only a few parties. A review of the two series of comments and reply comments filed with the Commission reveals that all sectors of the natural gas industry took the opportunity to make their views known and address the arguments raised by other parties.

The repeated notices and comments which characterize this proceeding demonstrate the thorough procedures used by the Commission. As this Court has stated, and as noted by the Court below, App. at 54, nothing permits "the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory minima." *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 548 (1978). There is no doubt that the Commission has done so here.

IV

The Court's Decision Below Gave Full Consideration To The Issues And Determined That The Commission's Decision Was Based Upon Substantial Evidence.

Petitioners raise a wide-range of issues which, in essence, challenge the reasonableness of the Commission's Order. Pursuant to Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b), the standard which is to be used by a Court in reviewing the Commission's factual findings is that of substantial evidence. *Public Service Commission of the State of NewYork v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980), *cert. denied*, 454 U.S. 879 (1981). The factual findings of the Commission are to be considered conclu-

sive if supported by substantial evidence. In this regard the Court is not to substitute its view of the facts for that of the Commission. *Colorado Interstate Gas Co. v. FPC*, 142 F.2d 943 (10th Cir. 1944), *aff'd.*, 324 U.S. 581 (1945), *reh'g denied*, 325 U.S. 891 (1945).

The Commission's examination of all aspects of this rule can only be described as overwhelming and conclusive. In fact, the reviewing Court below has so found. The Court's conclusion is illustrative in describing the breadth of the Commission's review where it states,

> In sum, we find that each of the order's essential elements is supported by substantial evidence. Since we have assured ourself "that the Commission has given reasoned consideration to each of the pertinent factors", it is not our province "to supplant the Commission's balance of these interests with one more merely to [our] liking", *Permian Basin*, 390 U.S. at 792.

App. at 42.

Thus, Petitioners' claims simply do not merit review by this Court.

CONCLUSION

For these reasons, the Petitions for a Writ of Certiorari should be denied.

Respectfully submitted,

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March 28, 1986

Supreme Court, U.S.
FILED
MAR 28 1986
JOSEPH F. SPANIOL, JR.
CLERK

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF CONSUMERS POWER COMPANY, *ET AL.*, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

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IN THE

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BRIEF OF CONSUMERS POWER COMPANY, *ET AL.*, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

INTRODUCTION

Respondents Consumers Power Company, Michigan Consolidated Gas Company, Natural Gas Pipeline Company of America, the Peoples Gas Light and Coke Company, American Iron and Steel Institute, Process Gas Consumers Group, Kansas Corporation Commission, Inter-City Gas Corporation, Michigan Gas Utilities Company, State of Michigan, Michigan Public Service Commission, Public Utilities Commission of the State of

California, Chattanooga Gas Company, a Division of Jupiter Industries, Inc., Columbia Gas Transmission Corporation, Consolidated Gas Transmission Corporation, Brooklyn Union Gas Company, and Public Service Commission of the State of New York file this brief in opposition to the petitions for certiorari in the above-captioned cases.[1]

STATEMENT OF THE CASE

This case involves orders issued by the Federal Energy Regulatory Commission (FERC or Commission), after extensive rulemaking proceedings, pursuant to provisions of the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982). The orders (the Order No. 380 series) prohibited interstate natural gas pipelines from imposing either (a) "minimum commodity bills" that require customers to pay for "variable costs"[2] with respect to minimum volumes of gas they do not actually purchase, or (b) "minimum take" provisions that require the purchase and receipt of specified volumes of gas.[3] Five natural gas pipeline companies have filed petitions for certiorari, seeking review of the unanimous decision of the United States Court of Appeals for the District of Columbia Circuit (Judges Tamm, Mikva, and Starr) that upheld those orders in all pertinent respects. The Court of Appeals also denied rehearing and rehearing en banc, with no member of the court requesting a vote for an en banc hearing.

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[1] A list of these respondents' parents, affiliates, and subsidiaries that are not wholly-owned is attached as an appendix to this brief.

References in the form "A.——" are to the Appendix to the Petition for a Writ of Certiorari filed by Transwestern Pipeline Company in No. 85-1219.

[2] These "costs" typically included payment of the pipeline's purchase price of gas, even if it was not acquired by the pipeline and delivered through the pipeline's system.

[3] The respondents have addressed in this brief only minimum bill, rather than minimum take, provisions.

The orders at issue represent an exercise of the FERC's authority and responsibility to conform its policies to new legislation and the shifting requirements of the public interest. In its initial notice of proposed rulemaking, the FERC noted a number of developments since the enactment in 1978 of the Natural Gas Policy Act (NGPA), 15 U.S.C. §§ 3301-3432 (1982), that changed the role and significance of minimum bills and demonstrated the need for a comprehensive reevaluation of those provisions. (A-79 to A-81.) The NGPA represented a fundamental departure from the previous statutory scheme governing prices paid for natural gas at the point of its production, i.e., at the wellhead. It established "a new system of natural gas pricing . . . needed to balance supply and demand." *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board of Mississippi*, 106 S. Ct. 709, 716 (1986). Under this regime, which calls for gradual deregulation of the wellhead prices for some categories of gas, "[t]he new federal role is to 'overse[e] a national market price regulatory scheme.'" *Id.* (citation omitted).

The FERC noted that the effectiveness of the NGPA's new market-based scheme of gas pricing was being significantly impeded by the presence of minimum bill provisions, which effectively compelled customers to purchase or pay for a predetermined volume of gas from a particular supplier, without regard to the price of or need for that gas. The FERC found that the economic roles of supply, demand, and price were undermined when a customer's purchases from a pipeline were dictated by a factor unrelated to the need for the gas or the availability of alternate supplies at a more favorable price. The FERC (without reference to antitrust law or analysis) characterized this feature of minimum bills as potentially anticompetitive and found the recovery of gas purchase costs (as well as other variable costs) through minimum bill provisions to be unjust and un-

reasonable and thus contrary to the requirements of the Natural Gas Act. (A-82 to A-85.)

The FERC also noted that the overall supply and demand characteristics of the industry had changed significantly since the passage of the NGPA. The NGPA permitted producers to charge higher, "incentive" prices for gas at the wellhead, and in response to these higher prices significant incremental supplies of gas became available. Roughly coincident with this increase of supply, a series of factors—conservation, a decline in worldwide petroleum prices, and the economic recession of the early 1980s—dramatically reduced the nationwide demand for gas. These countervailing trends—increasing natural gas supplies and diminishing demand for gas—left many pipeline customers without adequate markets for the gas they were required to purchase or pay for under their minimum bills. Under such circumstances, a pipeline that received payment for gas not purchased could "recover" costs that it did not incur and obtain windfall profits.[4] The Commission found that minimum bills operating in this fashion are unjust and unreasonable. (A-82 to A-85.)

Although many parties in the rulemaking had urged the total elimination of minimum bills, the FERC limited its orders to preclude only the recovery of variable costs through minimum bills. The Commission declined in the rulemaking to prohibit the recovery of fixed costs by pipelines through minimum bill provisions or customer demand charges.[5] Fixed costs are, by regulatory

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[4] Consumers Power Company, for example, estimated that it would have faced $250 million of minimum bill penalties to Trunkline Gas Company in the absence of a short-term settlement of a litigated proceeding before the FERC in 1983. (A-82.)

[5] For a description of the manner in which demand charges and commodity charges are structured under a typical two-part rate for pipeline sales service, see A-71 to A-73.

definition, those costs incurred by a pipeline whether it purchases and sells gas or not.

Noting the limited nature of its action, the Commission rejected the argument that the prohibition of variable-cost minimum bills amounted to a "restructuring" of the gas industry because it would relieve customers of the obligation to purchase gas without relieving pipelines of the obligation to provide service upon demand. The FERC observed that this argument overlooks that Order No. 380 permits a pipeline to continue to recover fixed costs through the operation of demand charges, which customers pay "whether or not they buy gas." (A-93.)

The Commission specifically addressed concerns about so-called "take-or-pay" provisions in pipeline-producer contracts under which pipelines undertake to prepay producers for a minimum quantity of gas over a specified period. To the extent that such prepayments are not satisfied by the pipeline's ultimate receipt of the prepaid gas, they may generate costs. The Commission noted that a pipeline may seek to recover such costs from its customers, if the pipeline in fact incurs them (A-77 to A-78), and Order No. 380 permits pipelines to continue to recover any such take-or-pay costs that are prudently incurred. The Commission also explained that the difficult issues pertinent to the distribution of prepayment costs among a pipeline's customers would be addressed in individual pipeline rate cases. (A-102 to A-107.)

The FERC's orders have had an immediate, concrete, and beneficial impact on the millions of consumers of gas nationwide, by precluding natural gas pipeline companies from charging their customers for gas that they did not purchase and costs that the pipelines did not incur. Order No. 380 has saved consumers millions of dollars, as the rulemaking record compiled before the FERC demonstrated it would. The Commission's actions

were essential to the administration of the Natural Gas Act, the purpose of which is "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388 (1959).

ARGUMENT

The petitions for writs of certiorari raise a multitude of issues. However, there is no conflict among the circuits with respect to any of the issues raised, and none of the issues is of sufficient importance to warrant this Court's review.

1. Petitioners contend that the Commission's orders endanger pipeline recovery of fixed costs and threaten to shift those costs to full requirements customers. The Commission specifically addressed these issues. The rule permits continued recovery of fixed costs through a minimum bill. Furthermore, customers remain obligated to pay all the fixed costs assigned to the demand and commodity components of a pipeline's rate. The Commission's action, therefore, protects full requirements customers and pipelines from bearing the cost of facilities constructed for customers that reduce their purchases below minimum bill levels.

2. There is also no basis for petitioners' claim that it was unreasonable for the Commission to decline to eliminate take-or-pay provisions in producer-pipeline contracts at the same time it eliminated variable-cost minimum bills. Petitioners argue that the two types of provisions are inextricably linked. They assert that, without the requirement to pay for variable costs in minimum bills, partial requirements customers will be able to switch more easily from their traditional pipeline suppliers to lower-cost pipelines, and the traditional suppliers will then be unable to meet their take-or-pay obligations.

The Commission gave considerable attention to this issue and concluded that "there is no clear nexus between a pipeline's annual take-or-pay obligations and its minimum commodity bills to its customers." (A-103.)[6] Reductions in purchases by any specific customer or group of customers will not necessarily result in increased pipeline take-or-pay liabilities to producers. For example, purchases by other customers may more than compensate for reductions in sales by partial requirements customers. In addition, most take-or-pay contracts contain make-up provisions that allow the pipeline to credit its take-or-pay payments against subsequent gas purchases that exceed take-or-pay levels, and make-up gas should be paid for by the customers that actually buy it and not by other customers that earlier reduced their purchases. (A-102 to A-105.) In any event, to the extent a pipeline incurs any take-or-pay costs,[7] the Commission's orders do not, as petitioners suggest, obligate full requirements customers to bear such costs, even in the short term. The rule leaves the allocation of any take-or-pay costs that are actually incurred for decision in the individual rate proceedings in which pipelines seek recovery of such costs. In those proceedings, the Com-

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[6] The Commission in any event was not legally required to resolve issues involving producer take-or-pay contracts at the same time it issued Order Nos. 380 and 380-A. As the court below found, "[a]n agency should not be paralyzed by having to decide all relevant issues at the same time. The agency's decision should be upheld unless the agency 'abuse[s] this flexibility by failing to consider . . . an issue whose resolution might seriously undercut the . . . rationale for its final action' . . . ." *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1159 (D.C. Cir. 1985) (citations omitted).

[7] The Commission acknowledged that initially there might be some cost shifting or take-or-pay cost increases on systems that lose partial requirements customers to other suppliers. It explained, however, that such shifts would be short-term and that all pipeline customers would benefit in the long term "as the industry moves towards a competitive balance." (A-99.)

mission can allocate such costs in a variety of ways. If the costs were not prudently incurred, the pipeline must bear them. If there is no finding of imprudence, the Commission could allocate costs to those customers that reduced their purchases, to those that switched to other suppliers, or to all customers. The Commission will also be free to develop other just bases for assigning such costs.

3. In their petition, Trunkline Gas Company and Panhandle Eastern Pipe Line Company have raised for the first time an argument that the Commission's orders conflict with the principles of the Natural Gas Policy Act (NGPA), by subjecting producer prices to market pressures (rather than only encouraging those prices to rise) and by interfering with the statutory mechanism for the pass-through of those prices. They did not raise this argument in the Court of Appeals at all and referred to it only fleetingly in their petition for rehearing before the Commission. Contrary to their arguments, the NGPA clearly contemplates that producer prices should be subject to market forces. *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi*, 106 S. Ct. 709, 716 (1986) (citing Sen. Rep. No. 95-436, at 10 (1977) ("new federal role is to 'oversee[e] a national price regulatory scheme' ")).[8]

4. There is no merit to petitioners' challenges to the rulemaking procedures that the Commission used in this

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[8] They also argue, more generally, that the Commission's orders promote head-to-head competition, in violation of principles of public utility regulation. However, the FERC's orders do not imperil recovery of fixed costs and thus retain significant protections from the allegedly adverse effects of competition. Moreover, the Natural Gas Act was not intended to prevent all competition among pipelines. Section 7 of the Act, by its terms, provides that the grant of a certificate does not confer a monopoly. 15 U.S.C. § 717f (1982). *See Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 959-61 (D.C. Cir. 1968).

case. Order No. 380 was issued pursuant to Section 5 of the Natural Gas Act, which authorizes the FERC to act "after a hearing." 15 U.S.C. § 717d (1982). This Court has held that informal rulemaking procedures may satisfy the requirement of a ratemaking hearing, *United States v. Florida East Coast Railway*, 410 U.S. 224, 241-42 (1973), and has consistently affirmed the authority of the FERC to establish rates on a nationwide basis through the use of informal rulemaking procedures. *FPC v. Texaco, Inc.*, 377 U.S. 33, 39-45 (1964); *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

In the Department of Energy Organization Act of 1977, Congress expressly sanctioned the FERC's use of informal rulemaking procedures for any ratemaking function set forth in the Natural Gas Act. 42 U.S.C. § 7173(c) (1982). Pursuant to that provision, the FERC need only "assure full consideration of the issues and an opportunity for interested persons to present their views." The proceeding leading to Order No. 380 comprised two rounds of written comments by interested parties. Ninety-five parties filed initial comments by September 29, 1983. On January 25, 1984, the Commission invited interested parties to file reply comments by February 13, 1984; thirty parties filed such comments. The Commission issued Order No. 380 on May 25, 1984. The FERC issued Order No. 380-A on July 30, 1984, in response to requests for rehearing, stay, or clarification filed by twenty-five parties.

No party demonstrated to the Court of Appeals that it had not been afforded full opportunity to present its views. The FERC and the Court of Appeals applied proper procedural standards, and there is no reason for this Court to review those standards. *See Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978).

The enormity of the problem facing pipeline customers and consumers had been made abundantly clear to the Commission by the time it issued the orders involved here. Distributors, consumer groups, and pipelines that bought gas from other pipelines had repeatedly challenged minimum bills, beginning in 1981. In all, twenty-four proceedings before the Commission had raised a minimum bill issue. Virtually every pipeline using minimum commodity bills was challenged. It was appropriate—indeed necessary—for the Commission finally to address and resolve this industry-wide problem on an industry-wide basis.

5. Petitioner ANR Pipeline Company (ANR) contends that the Court of Appeals' ruling upheld the authority of the FERC to abrogate the terms of settlement agreements that it has previously approved. The Court of Appeals, however, made no such ruling. As ANR itself notes in its Petition for Certiorari at 15, the Court of Appeals merely determined that the terms of the particular settlement agreement cited by ANR did not preclude the FERC from applying Order No. 380 to ANR. This narrow issue does not warrant review by this Court.

CONCLUSION

For the reasons stated, the petitions for a writ of certiorari should be denied.

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March 28, 1986

APPENDIX

APPENDIX

LIST OF RESPONDENTS' PARENTS, AFFILIATES, AND SUBSIDIARIES THAT ARE NOT WHOLLY-OWNED

Columbia Gas Transmission Corporation

Big Marsh Oil Company
Columbia Coal Gasification Corporation
Columbia Gas Development of Canada Ltd.
Columbia Gas Development Corporation
Columbia Gas of Kentucky, Inc.
Columbia Gas of Maryland, Inc.
Columbia Gas of New York, Inc.
Columbia Gas of Ohio, Inc.
Columbia Gas of Pennsylvania, Inc.
Columbia Gas of Virginia, Inc.
Columbia Gas System Service Corporation
Columbia Gulf Transmission Corporation
Columbia Hydrocarbon Corporation
Columbia LNG Corporation
Columbia Natural Resources, Inc.
Commonwealth Gas Pipeline Corporation
Commonwealth Gas Services, Inc.
Commonwealth Propane, Inc.
Inland Gas Company, Inc.
TriStar Gas Marketing, Inc. (pending SEC approval)

Consolidated Gas Transmission Corporation

Consolidated Natural Gas Company
The East Ohio Gas Company
The Peoples Natural Gas Company
Hope Gas, Inc.
CNG Producing Company
CNG Development Company
Consolidated System LNG Company
CNG Coal Company
CNG Research Company
West Ohio Gas Company

River Gas Company
CNG Energy Company
Consolidated Natural Gas Service Company, Inc.

Inter-City Gas Corporation

EKW Appliances, Inc.
Greater Winnipeg Gas Corporation
ICG Scotia Gas Ltd.
Keeprite, Inc.
Roam Communications Limited
The Mortgage Insurance Company of Canada
Vancouver Island Gas Company

Michigan Consolidated Gas Company

Primark Corporation

Michigan Gas Utilities Company

Michigan Energy Resources Company

Natural Gas Pipeline Company of America

Natural Gas Pipeline Company of America is a subsidiary of MidCon Corp., a majority of whose shares are owned by Occidental Petroleum Corporation.

MidCon Corp. is the parent of the following subsidiaries:

Alabama Gulf South Pipeline Company, Inc.
Alabama Methane Production Company
Anthrust, Inc.
Cotton Petroleum Corporation
Exeter Capital Corporation
Exeter Drilling Company
Exeter Exploration Company
Exeter Service Company
Gulf South Pipeline Company
Harper Oil Company
Lynx Drilling Company

MCN Acadian Gas Pipeline Corp.
MCN Bayou Interstate Pipeline Corp.
MCN Calcasieu Gas Gathering Corp.
MCN Coal Gasification Company
MCN Equities, Inc.
MCN Louisiana Industrial Gas
MCN Overseas Inc.
MCN Pelican Interstate Gas Corp.
MCN Pelican Transmission Corp.
MCN Pontchartrain Natural Gas Corp.
MCN Research, Inc.
MCN Spindletop Gas Distribution Corp.
MCN Technologies, Inc.
MCN Transmission, Inc.
MCN Utah Pipeline Corp.
MCN-TEX Corp.
MCN-Trinidad and Tobago LNG Company
MidCon Arkansas Pipeline Corp.
MidCon Colorado Pipeline Corp.
MidCon Acquisition Corp.
MidCon Enterprises, Inc.
MidCon Exploration Company
MidCon Gas Products, Inc.
MidCon General, Inc.
MidCon Holding Corp.
MidCon Hydrocarbons Corp.
MidCon Illinois Pipeline Corp.
MidCon International N.V.
MidCon Louisiana Pipeline Corp.
MidCon Michigan Pipeline Corp.
MidCon Mississippi Natural Gas Pipeline Corp.
MidCon Missouri Pipeline Corp.
MidCon Nebraska Pipeline Corp
MidCon New Mexico Pipeline Corp.
MidCon Oklahoma Natural Gas Pipeline Corp.
MidCon Plants, Inc.
MidCon Razorback Pipeline Corp.
MidCon Sales Inc.

MidCon Texas Pipeline Corp.
MidCon Ventures, Inc.
MidCon Wyoming Pipeline Corp.
MidOk Pipeline Company
MidTex Pipeline Company
Mississippi Gulf South Transmission Company
Mississippi River Transmission Corporation
NAERCO, Inc.
NGP-LNG, Inc.
Petrounited, Inc.
South Gulf Management, Inc.
TPC Pipeline Company
Texas Gulf South Pipeline Company
Texoma Production Company
Troy Potter Inc.
UER Gas Trading, Inc.
UER Marketing Company
UER Overseas Finance, N.V.
UER Services, Inc.
United Energy Resources, Inc.
United Energy Services Company
United Gas Pipe Line Company
United Texas Transmission Company
Western Energy Transport Company

The Peoples Gas Light and Coke Company

People's Energy Corporation

Process Gas Consumers Group

American Standard, Inc.
Armco, Inc.
Bethlehem Steel Corporation
Carpenter Technology Corporation
Cone Mills Corporation
Corning Glass Works
General Motors Corporation
Owens-Corning Fiberglas Corporation
Owens-Illinois, Inc.

(8) (5) (5) (5) (6)

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In the Supreme Court of the United States

OCTOBER TERM, 1985

Court, U.S.
FILED
APR 29 1986
JOSEPH F. SPANIOL, JR.
CLERK

TRANSWESTERN PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ANR PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TEXAS EASTERN TRANSMISSION CORP., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TRUNKLINE GAS CO. AND
PANHANDLE EASTERN PIPE LINE CO., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ARKLA ENERGY RESOURCES, ETC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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28 pp

QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission reasonably exercised its statutory authority to regulate natural gas pipeline rates by adopting a rule requiring pipelines to eliminate from their tariffs "minimum bill" provisions that permit a pipeline to charge a customer for the variable costs associated with a specified volume of gas even if the customer does not actually take delivery of the gas from the pipeline.

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In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1219

TRANSWESTERN PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

No. 85-1236

ANR PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

No. 85-1237

TEXAS EASTERN TRANSMISSION CORP., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

No. 85-1250

TRUNKLINE GAS CO. AND PANHANDLE EASTERN PIPE LINE CO., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

No. 85-1252

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FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A56) is reported at 770 F.2d 1144.[1] The orders of the Federal Energy Regulatory Commission (Pet. App. A71-A128, A129-A225, A226-A230, A231-A270, A271-A279) are reported at 27 F.E.R.C. ¶ 61,318; 28 F.E.R.C. ¶ 61,175; 29 F.E.R.C. ¶ 61,076; 29 F.E.R.C. ¶ 61,077; and 29 F.E.R.C. ¶ 61,332.

JURISDICTION

The judgment of the court of appeals (Pet. App. A57-A68) was entered on August 20, 1985, and petitions for rehearing were denied on October 25, 1985 (Pet. App. A69-A70). The petition for a writ of certiorari in No. 85-1219 was filed on January 21, 1986; the petitions in Nos. 85-1236 and 85-1237

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[1] "Pet. App." refers to the appendix to the petition in No. 85-1219.

were filed on January 22, 1986; and the petitions in Nos. 85-1250 and 85-1252 were filed on January 23, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Natural Gas Act, 15 U.S.C. 717 *et seq.*, empowers the Federal Energy Regulatory Commission to regulate the rates charged by natural gas pipelines for sales of natural gas. This case involves a rule promulgated by the Commission pursuant to this statutory authority; the Commission barred natural gas pipelines from using "minimum commodity bills" to charge their customers for the variable costs associated with a specified volume of gas whether or not the customer takes delivery of that much gas. The Commission also prohibited the use of similar tariff and contract provisions requiring a customer to take physical delivery of a specified amount of gas.

a. The rates charged by natural gas pipelines generally consist of two basic components. A "demand charge" is imposed upon all customers who are entitled by contract to receive a specified amount of natural gas from the pipeline. As the court of appeals explained, this charge "is not levied upon each unit of gas sold, but rather is a fixed sum, assessed in proportion to the maximum quantity of gas the customer is entitled to demand under the contract. The demand charge thus recoups some portion of the fixed costs incurred by the pipeline in providing a transmission mechanism of sufficient capacity to meet the customer's peak-load minimum entitlement." Pet. App. A19; see also *id.* at A71-A72.

The second component of pipelines' rates is the "commodity charge" levied upon each unit of gas sold. It is through this charge that a pipeline recovers its variable costs as well as the fixed costs that are not recovered through the demand charge. Pet. App. A18-A19; A72. Some pipelines include in their rate schedules a specific type of commodity charge known as a "minimum commodity bill." These minimum bill provisions essentially establish a minimum commodity charge, requiring the customer to pay for a certain quantity of gas even if the customer does not take delivery of any gas during the relevant time period. *Id.* at A19; A72-A73.

The Commission in the past has permitted pipelines to utilize minimum bill provisions because these provisions assist in the recovery of fixed costs. Minimum bill provisions typically are imposed upon a pipeline's "partial requirements" customers—those customers with access to more than one pipeline supplier.[2] Partial requirements customers can "swing from one source of supply to another." Pet. App. A75; see also *id.* at A19. If a partial requirements customer takes less gas from a pipeline than the pipeline expected to sell, and the pipeline is unable to sell the gas elsewhere, the revenue received by the pipeline pursuant to its commodity charge will be reduced and the pipeline may fail to recover its fixed costs.

Minimum bills guarantee a minimum payment by partial requirements customers; they provide protection against underrecovery of fixed costs and ensure that partial requirements customers bear an appropriate share of fixed costs. Minimum bills also pre-

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[2] "Full requirements" or "captive" customers are those who purchase their entire natural gas supply from one pipeline. Pet. App. A75.

vent pipelines from incurring the "take or pay" costs that can result when the pipeline's contract with its supplier provides that the pipeline will take a particular amount of gas or pay for that amount of gas. If the pipeline's sales decrease, the pipeline may not take the required quantity of gas and may be forced to make "take or pay" payments to its supplier. Since minimum bills discourage partial requirements customers from shifting suppliers, they assist pipelines in avoiding take or pay costs. Pet. App. A19-A20.

If the pipeline does incur take or pay costs, these costs generally may be included in the pipeline's rate base; the take or pay costs are treated as an investment upon which the pipeline may earn its prescribed rate of return. The typical take or pay contract provision then allows a pipeline five years to take delivery of the gas for which it has prepaid. If the pipeline fails to take delivery of the gas within the required period, it can recover prudently incurred take or pay costs. Pet. App. A20-A21; A78.

It is significant that the justifications for minimum bills traditionally focused upon the recovery of pipelines' fixed costs. As the Commission observed, "[t]he recovery of *variable* costs via minimum commodity bills [was] simply not an issue in the past. This is because interstate pipelines generally were buying all the gas they were offered * * * and because the major variable cost—the gas supply itself —represented a far smaller proportion of the minimum commodity bill than it does today." Pet. App. A79 (footnote omitted; emphasis in original); see also *id.* at A21.

b. In August 1983, the Commission issued a Notice of Proposed Rulemaking stating that it proposed

to eliminate minimum bills from pipelines' tariffs to the extent these provisions permitted the recovery of variable costs. The notice solicited comments from interested parties regarding the Commission's proposal. Pet. App. A22, A73-A74.

After considering comments from more than 90 parties, the Commission concluded that "collection of variable costs via a pipeline's minimum bill tariff provision is unjust and unreasonable under the Natural Gas Act" (Pet. App. A74). It promulgated a rule declaring "inoperative and of no effect at law" existing rate schedules and tariffs that provide for "recovery of purchased gas costs for gas not taken by the buyer"; the rule also bars the filing of new rate schedules or tariffs providing for "recovery of variable costs associated with gas not taken by the buyer" (*id.* at A123). Pipelines remain free to continue to utilize minimum bill provisions to recover their fixed costs.[3]

The Commission found that minimum bills had "become a vehicle by which enormous purchased

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[3] The Commission subsequently extended this rule to cover "minimum take" provisions, under which the customer is required to take physical delivery of a minimum quantity of gas and does not have the option of paying for gas not taken (see Pet. App. A231-A268). It concluded that "minimum take provisions operate to prevent purchasers from pursuing a least-cost purchasing strategy, thereby resulting in charges to customers in excess of the lowest reasonable rate consistent with reliable, long-term supply" (*id.* at A235) and found that minimum take provisions "share fully the market-distorting influences of the variable costs in minimum commodity bills" (*id.* at A236). The Commission therefore found that the same rule should apply to minimum take provisions, noting that a pipeline remained free to "seek recovery of fixed costs incurred as a result of a customer's failure" to meet its purchasing obligations (*ibid.*).

gas 'costs' can be collected even if the pipeline never actually incurs such costs" (Pet. App. A81). It stated (*id.* at A82):

> By definition, there are no variable costs incurred for volumes not purchased for resale. Accordingly, a minimum commodity bill that includes variable costs gives a pipeline the right to collect for "costs" it has not in fact paid out to provide jurisdictional natural gas service. On its face then, a minimum bill that permits such "cost" collection is unjust and unreasonable.

The Commission noted that the amounts of variable "costs" collected pursuant to minimum bills had increased dramatically as a result of the deregulation of natural gas prices: "gas prices have risen to the point that purchased gas costs make up the majority of a pipeline's variable costs and hence its commodity rate" (*id.* at A81). The elimination of variable costs from minimum bill provisions would prevent pipelines from reaping this financial windfall.

The Commission further found that minimum bills permitting recovery of variable costs had the effect of restraining competition, with the result that gas prices were " 'propped up' * * * at levels higher than the market would otherwise support" (Pet. App. A86 (footnote omitted)). A pipeline's "partial requirements customers cannot purchase lower cost gas supplies if they are required to pay for the higher-cost gas they do not take" (*id.* at A85). Minimum bill provisions thus insulate pipelines from market pressures: "[w]hen distributors and pipelines are required to purchase gas under a minimum commodity bill, even when less expensive sources are available, the supplier pipeline can continue to oper-

ate profitably without having to worry about keeping its gas costs at a reasonable level" (*id.* at A86).

Moreover, the Commission found that including variable costs in minimum bills "deprive[s] producers of the opportunity to increase sales volumes in exchange for accepting a reduction in price" (Pet. App. A87). This is because "[a] pipeline cannot offer to buy more gas from a producer that lowers its prices if that pipeline's customers are under minimum commodity bill obligations elsewhere" (*ibid.*); the pipeline would not be able to dispose of the larger quantity of gas because it would not be able to increase its own sales.

The Commission concluded that these significant adverse effects of permitting recovery of variable costs through minimum bill provisions outweighed any possible benefits of allowing such cost recovery. It first observed that the justifications traditionally advanced in support of minimum bill provisions concerned the recovery of fixed costs. This function was important when pipelines were making large investments in new facilities, but the Commission noted that "most pipelines are not in this situation" (Pet. App. A90). Many pipelines now use a rate approach that "permits recovery of more fixed costs in the demand charge and diminishes much of the formerly perceived need for minimum commodity bills" (*ibid.*). Moreover, pipelines using more traditional rate approaches still would be permitted to recover fixed costs through minimum bills; the rule bars only the inclusion of variable costs.

The Commission rejected claims that its new rule would adversely affect customers who rely upon a single pipeline as their only source of natural gas. The Commission noted that "viewed from a national

perspective, the rule may create offsetting benefits and detriments to captive customers, depending upon whether they are served by a high-cost or a low-cost pipeline" (Pet. App. A96-A97 (footnote omitted)). And customers of a high-cost pipeline would be protected from unwarranted rate increases through the Commission's regulation of pipeline rates under the Natural Gas Act (*id.* at A97-A100).

Finally, the Commission determined that pipelines should not be permitted to recover take or pay costs through minimum bills.[4] The Commission observed that a pipeline customer's decision to reduce its take of gas below minimum bill levels would not necessarily force the pipeline to incur take or pay costs. In addition, revenues from minimum bill provisions previously had not been viewed as compensating pipelines for take or pay costs; rather, "existing minimum commodity bills seem designed to prevent take-or-pay prepayments from being incurred in the first instance, by discouraging consumer cutbacks. This effect is * * * anti-competitive, unjust, and unreasonable." Pet. App. A103-A104.

Even if a pipeline did incur increased take or pay costs, "it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later" (Pet. App. A104). Requiring customers subject to minimum bills to absorb a pipeline's take or pay costs also would be inequitable, the Commission found, because

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[4] As discussed above (see page 5, *supra*), take or pay costs are costs incurred by a pipeline pursuant to a provision in the contract between the pipeline and its supplier requiring the pipeline to take delivery of a specified quantity of gas from the supplier or pay for that quantity of gas.

"full requirements customers not subject to a minimum commodity bill may be as much responsible for take-or-pay payments as swing customers who are subject to a minimum commodity bill" (*id.* at A105). If the pipeline "is permitted to 'cover' its take-or-pay costs via minimum bill charges, the customers subject to a minimum commodity bill will bear a disproportionate burden of the pipeline's take-or-pay obligations" (*ibid.*).[5]

2. The court of appeals unanimously affirmed the Commission's decision in virtually all respects (Pet. App. A1-A56).[6]

The court first addressed the Commission's statutory authority to issue the rule barring recovery of variable costs through minimum bill provisions. It stated that Section 5 of the Natural Gas Act, 15 U.S.C. 717d, empowers the Commission to fix "just and reasonable" rates and found that this authority, combined with the Commission's general rulemaking power (see 15 U.S.C. 717o), justified the issuance of the rule (Pet. App. A24-A25). The court also rejected several challenges to the Commission's statutory authority. First, it found that the elimination of variable costs from minimum bill provisions did

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[5] The Commission observed that the allocation of take or pay costs among pipeline customers might present special considerations warranting the allocation of such costs in a manner different from the allocation of other costs. It directed the Commission staff to study this question and address the issue in individual pipeline rate proceedings. Pet. App. A105-A107.

[6] The court remanded for further consideration the Commission's decision that downstream pipelines cannot recover through minimum bills certain fixed costs that their pipeline suppliers may include in minimum bills. Pet. App. A46-A50.

not constitute an impermissible revocation of the conditions of the certificates of public convenience and necessity issued to pipelines under Section 7 of the Natural Gas Act, 15 U.S.C. 717f. The court noted that certification of a pipeline's initial terms of service does not constitute a guarantee that those terms will not be changed pursuant to the Commission's authority to regulate rates under Section 5 (Pet. App. A25 n.9). Moreover, the court held, "elimination of minimum bills has no effect on the pipeline's *authorized* service. The Order merely addressed the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5" (*ibid.* (emphasis in original)).

Second, the court rejected arguments that the rule impermissibly altered the terms of existing contracts, holding that "section 5 gives the Commission authority to alter terms of any existing contract found to be 'unjust' or 'unreasonable'" (Pet. App. A25-A26 n.9). Third, the court concluded that various settlement agreements in rate proceedings did not bar the Commission from adopting the rule; the court found that the rule did not conflict with the terms of the settlements (*id.* at A26-A29).[7]

On the merits, the court held that the Commission's decision to adopt the rule was supported by substantial evidence. The court identified (Pet. App. A33) "[t]hree essential findings" underlying the Commission's determination:

> First, minimum bills allow pipelines to recover for various costs that they do not incur. Second,

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[7] The court also held that the application of the rule to imported gas was not inconsistent with the Economic Regulatory Administration's authorization of the importation of that gas (Pet. App. A30-A31).

> minimum bills prevent gas purchasers from purchasing the lowest priced gas and hence artificially maintain high gas prices. Third, the benefit of eliminating variable cost recovery through minimum bills outweighs the negative impact such action will have upon pipelines and upon full requirements customers.

The court held that "the factual support for the overrecovery rationale is unassailable. Minimum bills allow [a] pipeline[] to charge for gas that its customer does not take; if the customer pays for gas not taken, the pipeline recovers for variable costs that it does not incur" (Pet. App. A33). The circumstance that a particular pipeline actually may not have overrecovered its costs did not undercut the Commission's conclusion, but "merely reflects the rational choice of its partial requirements customers to take gas that they must pay for rather than pay for gas not taken. The lynchpin [*sic*] of the Commission's rationale, however, is the *potential* for overrecovery" (*id.* at A33-A34 (emphasis in original)).

The court also upheld the Commission's determination that the record showed that minimum bills adversely affect competition. The court emphasized that the Commission's determination did not rest solely upon economic theory, observing that "[t]he record is replete with comments from customers who have been unable to purchase lower cost gas because of minimum bills and minimum take provisions" (Pet. App. A36 (footnote omitted)). The court concluded that "[e]ven if some customers do not pursue * * * [a least cost purchasing] strategy, the Commission has presented evidence that many customers will, and thus the elimination of minimum bills can reasonably be expected to lower gas costs and spur competition among pipelines" (*id.* at A37).

The court also upheld the Commission's determination that the benefits of eliminating variable costs from minimum bills outweighed any potential harms to pipelines and captive customers from that course of action. The court noted that "[t]he Commission gave considerable attention to the difficult take-or-pay issue" (Pet. App. A38). It agreed with the Commission that reductions in purchases by partial requirements customers would not necessarily result in take or pay liability and that pipelines could avoid take or pay costs by lowering prices to maintain sales. The court further noted that the increased price competition resulting from elimination of minimum bills "may spur renegotiation of take-or-pay clauses with gas producers" (*id.* at A39).

The court recognized "that many of the policy considerations that support the elimination of variable cost recovery for the minimum bill might support the elimination of take-or-pay clauses" (Pet. App. A39-A40), but it upheld the Commission's decision to take action only with respect to minimum bills. The court observed that the agency was not required to address all problems in a single rulemaking; rather, "[t]hat which we can require, the Commission has here provided: an explicit assessment of the relationship between the action taken and the issue deferred, and a reasonable conclusion that the public interest can best be advanced by the measured step taken" (*id.* at A40).

The court also determined that the Commission had adequately considered claims that pipelines' captive customers would bear increased costs if the pipelines lost sales (Pet. App. A41-A42). The court stated that "[h]ad the Commission either failed to address the problems faced by captive customers or

engaged in a less than candid balancing of the costs, its determinations perhaps would be vulnerable on review. The Commission, however, exhaustively considered these problems, recognized that some harm would result from the elimination of minimum bills, indicated it would consider in individual cases whether particular cost swings warrant special allotment of costs, and, finally, concluded that the benefit of increased competition would eventually inure to even the captive customer of a high-priced pipeline. These are the hard choices agencies are empowered—indeed required—to make" (*id.* at A41-A42).

Finally, the court affirmed the Commission's decision to address the minimum bill issue through a rulemaking proceeding rather than in pipeline-by-pipeline adjudications. It found that the "generalized nature of the problems addressed * * * did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking * * * was a manifestly reasonable method of addressing the systemic problems of the natural gas market" (Pet. App. A52) (footnote omitted)).[8]

ARGUMENT

The thorough opinion of the court below, upon which we rely, is correct and does not conflict with any decision of this Court or another court of appeals. Further review by this Court is not warranted.

1. Petitioners present two challenges to the Commission's statutory authority to issue a rule prohibiting recovery of variable costs through minimum bills. First, petitioners argue (85-1219 Pet. 10-11; 85-1237

[8] The court also upheld the Commission's decision granting an exemption from the rule to one pipeline company (Pet. App. A43-A46).

Pet. 8-10) that the rule destroys the mutuality of obligation between pipelines and their customers. The court of appeals properly characterized this claim as "frivolous" (Pet. App. A25 n.9).

Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), expressly provides that "[w]henever" the Commission finds that "any rate [or] charge" or "contract affecting such rate [or] charge" is "unjust, unreasonable, unduly discriminatory, or preferential," the Commission shall determine the "just and reasonable rate, charge, * * * or contract to be thereafter observed and in force, and shall fix the same by order." As this Court has recognized, Section 5 confers upon the Commission "plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." *Permian Basin Area Rate Cases*, 390 U.S. 747, 783-784 (1968); see also *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 646-647 (1972). In *Permian Basin*, the Court upheld an order issued by the Federal Power Commission that barred the use of escalation clauses in existing contracts; the order in this case invalidating another sort of unreasonable contract provision therefore plainly falls within the Commission's statutory authority.[9]

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[9] Petitioners' references (85-1219 Pet. 8-10) to the role of contracts under the Natural Gas Act are irrelevant. Contract provisions cannot remain in effect when they contain terms found by the Commission to be unlawful under Section 5.

Petitioners observe (85-1219 Pet. 13-14) that the minimum bill provisions were approved by the Commission in earlier proceedings. This Court in *Permian Basin Area Rate Cases, supra*, recognized that such prior administrative action was immaterial; it declined to set the Federal Power Commission's order aside "merely because the Commission ha[d] on an earlier occasion reached another result; administrative author-

Moreover, petitioners' argument is completely insupportable in the present context because petitioners have not been deprived of the principal benefit of minimum bill provisions. Pipelines are barred only from recovering variable costs (principally the cost of purchased gas), and a pipeline will not incur this cost if the customer chooses not to purchase the gas. Thus, the minimum bill provision still fulfills its purpose of assisting pipelines in recovering their fixed costs; pipelines simply cannot recover variable costs for gas that they do not sell.[10]

Second, petitioners assert (85-1219 Pet. 22-25; 85-1252 Pet. 8-14) that the Commission lacks authority to issue the rule because the rule alters the terms of certificates of public convenience and necessity previously issued by the Commission pursuant to Section 7 of the Natural Gas Act, 15 U.S.C. 717f. Section 7 provides that a natural gas company must obtain a certificate of public convenience and necessity before it begins operations; the circumstance that a minimum bill provision was one of the terms and conditions of a pipeline's original certificate is simply irrelevant here. As the court of appeals observed, "elimination of minimum bills has no effect on the pipeline's *authorized* service. The [Commission's] Order merely addresses the *rates* the pipeline may

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ities must be permitted, consistently with the obligations of due process, to adapt their rules and policies to the demands of changing circumstances" (390 U.S. at 784).

[10] Petitioners argue (85-1219 Pet. 21-22) that they will be unable to recover take or pay costs but, as we discuss below (see pages 19-20), it is not clear that the rule regarding minimum bills will result in the imposition of take or pay costs upon pipelines and, in any event, recovery of these costs traditionally has not been a purpose of minimum bills.

charge its customers and therefore was properly issued pursuant to Section 5" (Pet. App. A25 n.9 (emphasis in original)).

Once a certificate of public convenience and necessity authorizing pipeline service is issued by the Commission, the pipeline becomes subject to the Commission's authority to set "just and reasonable" rates. The Commission is free to utilize its Section 5 rate regulating authority to alter the rates contained in the original certificate. See *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. at 643, 646-647 (Commission may use its Section 5 authority to regulate rates to release pipelines from their obligation to deliver certificated quantities of gas "whether or not it could also invoke § 7 for that purpose"); *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 392 (1959); *Pacific Gas Transmission Co.* v. *FPC*, 536 F.2d 393, 395-397 (D.C. Cir.), cert. denied, 429 U.S. 999 (1976). The Commission otherwise would be powerless to adjust the rate terms set forth in the original certificate. Indeed, the Commission itself concluded that Section 5 "*require*[*s*] the Commission to change terms and conditions under which a pipeline renders a certificated service if those terms and conditions result in rates and charges which are subsequently found unjust and unreasonable" (Pet. App. A135 (emphasis in original)).[11]

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[11] Petitioner Arkla Energy Resources claims (85-1252 Pet. 10-12) that the Commission may not use its Section 5 authority to prohibit minimum take provisions. However, the Commission's Section 5 authority extends to all terms and conditions of service affecting rates and charges; minimum take provisions plainly fall within this category. See page 6 note 3, *supra*.

Petitioner ANR Pipeline Co. asserts (85-1236 Pet. 14-16) that the Commission exceeded its statutory authority in prom-

2. Most of the arguments advanced by petitioners relate to the propriety of the Commission's policy determination. The court of appeals' thorough analysis of these issues (Pet. App. A32-A50) conclusively demonstrates that substantial evidence supports the Commission's decision to bar recovery of variable costs through minimum bills. This Court has stated repeatedly that the courts of appeals bear principal responsibility for determining whether an agency's decision is supported by substantial evidence; this Court will intervene only when the court of appeals has "misapprehended or grossly misapplied" the standard of review. *American Textile Manufacturers Institute* v. *Donovan*, 452 U.S. 490, 523 (1981); *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 309-310 (1974). Petitioners do not even come close to showing that the court of appeals committed such an error here.

Petitioners do not dispute that recovery of variable costs through minimum bills results in a windfall to

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ulgating the rule because the rule abrogates a rate proceeding settlement agreement to which the Commission was a party. The court of appeals correctly concluded (Pet. App. A27-A29) that the rule did not abrogate the settlement agreement. The settlement agreement "merely defers resolution of the minimum bill issue" (*id.* at A29) and expressly states that "no party waives any rights with respect to the substantive standards for decision which should be applied herein" (85-1236 Pet. B1-B2). Thus, the settlement did not exclude the issue from the general rulemaking proceeding (Pet. App. A29).

Moreover, the Commission surely was correct in concluding (Pet. App. A110) that it may utilize its Section 5 rate regulating authority to alter a provision of a settlement agreement. Otherwise, the Commission could be bound forever by a settlement, regardless of how unjust or unreasonable the terms of the settlement had become.

a pipeline because the pipeline has not sold any gas and therefore has not incurred any variable costs. Several petitioners do assert that the Commission erred in concluding that the provisions are anticompetitive (85-1219 Pet. 18-20) or that the Commission should not have considered competition in its analysis (85-1237 Pet. 7; 85-1250 Pet. 10-15). But the Commission surely did not err in concluding that the effect of minimum bill provisions upon competition is a factor that may be considered in assessing the reasonableness of the provisions under Section 5. Congress itself has placed great emphasis upon encouraging reliance upon market forces in the natural gas industry. See *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board*, No. 84-1076 (Jan. 22, 1986), slip op. 11. And petitioners have not presented evidence contradicting the Commission's careful analysis of the competitive effect of these provisions. See Pet. App. A34-A37, A85-A92; see also pages 7-8, *supra*.

Petitioners' basic argument (85-1219 Pet. 21-22; 85-1236 Pet. 9-14; 85-1237 Pet. 14-15; 85-1250 Pet. 15-19) is that pipelines will be harmed financially by the Commission's rule because they will be required to bear take or pay costs. But the Commission and the court of appeals agreed that the elimination of variable costs from minimum bills would not necessarily result in the imposition of take or pay liability upon pipelines. The Commission summarized its conclusions as follows:

> [C]ustomer cutbacks below minimum bill levels may not cause *any* take-or-pay costs. Second, even if take-or-pay payments do result from such cutbacks, existing minimum commodity bills generaly [*sic*] do not serve to compensate for the

> cost of the take-or pay gas, and thus do not protect a pipeline's remaining customers from any resulting rate increases. Third, it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later.

Pet. App. A104 (emphasis in original); see also *id.* at A39.

Petitioners argue that the new rule will affect their "very viability as * * * continuing entit[ies]" (85-1250 Pet. 17) and that they have been placed in "a contractual vise" (85-1237 Pet. 14), but these assertions were for the Commission to evaluate. As the Commission and the court of appeals observed, pipelines might be able to sell the requisite quantity of gas by lowering prices, or they might be able to eliminate or reduce their take or pay obligations through renegotiation with gas producers. Pet. App. A39, A172, A182-A183. Moreover, a pipeline that does incur take or pay costs generally may include those costs in its rate base and, if necessary, can recover prudently incurred take or pay costs from its customers (see page 5, *supra*). Thus, a variety of methods are available to pipelines to ameliorate potential take or pay liability.[12]

3. Petitioners also contend (85-1219 Pet. 12-17; 85-1237 Pet. 10-13) that the Commission erred be-

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[12] Petitioners state in conclusory terms that the rule adopted by the Commission will increase costs for captive customers of pipelines (85-1236 Pet. 8, 10), but they present no evidence contradicting the Commission's conclusion that such customers will benefit in the long term from the elimination of variable costs from minimum bills and can be protected in the interim from improper rate increases (Pet. App. A95-A100).

cause it implemented its new policy regarding minimum bills by issuing a rule rather than undertaking individual pipeline-by-pipeline adjudications. These claims are without merit.

The Commission plainly has statutory authority to set rates and charges by rulemaking rather than adjudication. Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), states that the Commission may establish just and reasonable rates "after a hearing," but the provision has not been construed to require a formal evidentiary hearing in every case. *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 840-841 (5th Cir.), cert. dismissed, 439 U.S. 801 (1978); *American Public Gas Association* v. *FPC*, 567 F.2d 1016, 1064-1067 (D.C. Cir. 1977), cert. denied, 435 U.S. 907 (1978); *Phillips Petroleum Co.* v. *FPC*, 475 F.2d 842, 848-851 (10th Cir. 1973), cert. denied, 414 U.S. 1146 (1974); see also *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, 241 (1973) (statutory requirement of a hearing satisfied by written comments). Moreover, Section 403(c) of the Department of Energy Organization Act, 42 U.S.C. 7173(c), provides that "[a]ny function * * * which relates to the establishment of rates and charges under the * * * Natural Gas Act * * * may be conducted by rulemaking procedures." Since the present proceeding obviously relates to "rates and charges," Section 403(c) authorized the Commission to proceed by rulemaking.

Petitioners surely are incorrect in asserting (85-1219 Pet. 15-17) that because the Commission's ratemaking decisions are reviewed under the "substantial evidence" standard (see 15 U.S.C. 717r(b)), the Commission may only set rates through adjudicatory proceedings. The standard of review applicable to an administrative decision does not affect the proce-

dure that the agency must follow in reaching that decision. Pet. App. A54-A55; *American Public Gas Association* v. *FPC*, 567 F.2d at 1067; see also *United States* v. *Florida East Coast Ry.*, *supra*. Indeed, a contrary conclusion would conflict directly with this Court's determination in *Vermont Yankee Nuclear Power Corporation* v. *NRDC*, 435 U.S. 519 (1978), that a court may not "overturn [a] rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the [Nuclear Regulatory] Commission so long as the Commission employed at least the statutory *minima*" (435 U.S. at 548).[13]

In view of the Commission's statutory authority to proceed by rulemaking, its decision to select that course of action plainly is not subject to challenge. See *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947) ("the choice made between proceeding by general rule or by individual ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency"). The court of appeals correctly concluded that "[t]he generalized nature of the problems addressed * * * did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking * * * was a manifestly reasonable method of addressing the sys-

[13] Petitioners contend that the rule set forth by this Court in *Vermont Yankee* is not applicable here because the present proceeding involves "fact-specific findings affecting a limited number of companies" (85-1219 Pet. 17). Petitioners' assertion is incorrect. The type of costs that may be recovered through minimum bills is a general issue affecting all natural gas pipelines that involves industry-wide questions; it therefore properly was addressed by the Commission through a rulemaking proceeding. See Pet. App. A52.

temic problems of the natural gas market" (Pet. App. A52 (footnote omitted)).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL 1986

☆ U. S. GOVERNMENT PRINTING OFFICE: 1986 491507 20202

Supreme Court, U.S.
FILED
MAY 14 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1219

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Supreme Court of the United States

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TRANSWESTERN PIPELINE COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF OF PETITIONER TRANSWESTERN PIPELINE COMPANY

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May 14, 1986

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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REPLY BRIEF OF PETITIONER TRANSWESTERN PIPELINE COMPANY

This brief is respectfully submitted by Transwestern Pipeline Company ("Transwestern") in reply to briefs filed by the Federal Energy Regulatory Commission ("Commission") and Southern California Gas Company ("SoCalGas").

The briefs in opposition, through repeated references to "tariff" provisions, seek to induce acceptance of the concept that Order No. 380 deals only with tariffs and "rates." Thus, the Commission in its Question Presented

refers solely to the elimination of gas costs from the tariff. No reference is made to contracts which the Commission had previously reviewed and approved under Section 7 of the Natural Gas Act, 15 U.S.C. § 717f (1982) ("Act"). No reference is made to minimum take provisions similarly approved, all of which Order No. 380 abrogates. Similarly, the SoCalGas statement of Questions Presented refers only to provisions contained in tariffs.[1] No reference is made to SoCalGas' September 25, 1967 contract with Transwestern. (See TW Pet. A-1).[2]

1. The Effect of Order No. 380 on Transwestern's Gas Costs and Sales.

SoCalGas argues that Order No. 380 has had "its desired effect." (SoCalGas Br. at 4). A reduction in Transwestern's gas cost is cited as an example. It is implied that Order No. 380 has caused Transwestern to be the "low price leader of supplies to Southern California." (SoCalGas Br. at 4).[3]

As SoCalGas notes, Transwestern's commodity rate is currently less than that of its principal competitor, El

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[1] Tariff provisions setting forth minimum bill and minimum take obligations may have their origin in contracts negotiated between the pipelines and distributors which have been approved by the Commission under Section 7 of the Act and restated under Commission regulations in tariff form or through filings unilaterally made by pipelines under Section 4 of the Act, 15 U.S.C. § 717c (1982). *Cf. Atlantic Seaboard Corp. v. FPC*, 404 F.2d 1268 (D.C. Cir. 1968). The issues presented by Transwestern's petition address solely minimum bill and minimum take provisions which are based on contracts which have been formally reviewed and approved by the Commission in proceedings under Section 7 of the Act.

[2] References to the Appendix are shown as "App. - ——." References to the separate appendix included with Transwestern's petition are shown as "TW Pet. A - ——."

[3] This is misleading. Transwestern has been able to lower its price to California through the exercise of "market-out" clauses incorporated in contracts prior to the advent of Order No. 380.

Paso Natural Gas Company. (SoCalGas Br. at 4). What SoCalGas does not state, however, is that even under these circumstances, primarily because of SoCalGas' purchase practices not controlled by Order No. 380, Transwestern's sales to California are at perilously low levels.

During April, 1986, SoCalGas purchased only approximately 294 MMcf of gas per day from Transwestern. This represents approximately 40 percent of its daily contracted and certificated volume level. Prior to Order No. 380, Transwestern's sales were in the 700 MMcf per day range. Thus far in May, 1986, purchases by SoCalGas have declined further to less than 250 MMcf per day. Transwestern's market, as a result of Order No. 380, is being displaced by lower-cost, uncertificated "spot gas," as well as by higher-cost Canadian gas, which has been exempt from the effect of Order No. 380 and which is delivered through SoCalGas' affiliate, Pacific Interstate Transmission Corporation. (App.-114). Transwestern's other customer, Northwest Central Pipeline Corporation ("NWC"), is currently purchasing virtually no volumes from Transwestern, although Transwestern contracted with that company and was certificated by the Commission to sell it a total of 250 MMcf of gas per day. *Transwestern Pipeline Co.*, 34 FPC 659 (1965); *Transwestern Pipeline Co.*, 43 FPC 322 (1970). Like SoCalGas, NWC's alternative supplies include both higher and lower-cost gas. The overall effect on Transwestern has been that, notwithstanding substantial price reductions, drastically lower takes by SoCalGas and NWC as a result of Order No. 380 are creating substantial take-or-pay controversies with producers.[4]

The Commission asserts that petitioners cannot legitimately complain because they "have not been deprived of

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[4] A substantial number of lawsuits and arbitration proceedings are now pending against Transwestern as a direct result of lower takes arising from the operation of Order No. 380.

the principal benefit of minimum bill provisions." (Comm. Br. at 16). This argument is made in the context of the elimination of variable costs. It ignores, however, the principal benefits of minimum bill and minimum take provisions, admitted elsewhere by the Commission, in protecting the pipelines against incurring "take-or-pay" liability. (Comm. Br. at 4, 5).

The Commission's rationalization for disregarding the take-or-pay effect of Order No. 380 is inapplicable to Transwestern. It is also nonsense. As noted in its brief, the Commission assumes, first, that the pipelines "might be able to sell the requisite quantity of gas by lowering prices." (Comm. Br. at 20). There is no evidence that Transwestern can do so. The Commission maintains further that pipelines "might" be able to eliminate or reduce take-or-pay obligations through renegotiation. Transwestern has been unable to do so. Producers have little incentive to give up take-or-pay claims and lower prices for no more than a chance to compete for future sales. With no assured market, Transwestern cannot offer any long-term assured level of takes. Finally, the Commission asserts that, if the pipeline does incur take-or-pay costs, such costs may be included in rate base and recovered if it is deemed that such payments were "prudently incurred." (Comm. Br. at 20).

Transwestern now estimates that as a result of Order No. 380 its take-or-pay exposure for the years 1985 and 1986 is in the $350 to $400 million range. It cannot finance amounts of this magnitude. Transwestern's net worth, as shown from its 1985 Form 2 filed with the Commission, is approximately $250 million. Its net plant in service as of December 31, 1985 was approximately $306 million. Even if it could finance such amounts and include them in rates, the effect, particularly if the impact of take-or-pay payments were forced into the commodity rate, would likely be to increase Transwestern's rates to non-competitive levels, further reducing its sales

and exacerbating its take-or-pay problems. The Commission should not be permitted to brush aside the dire consequences of Order No. 380 by speculating that the pipelines can resolve whatever problems that rule might create.

2. Reply to SoCalGas' Characterization of Transwestern's Minimum Bill and Minimum Take Provisions as "Severe Tariff Restrictions."

SoCalGas states that the minimum take provisions in Transwestern's tariff require it to take from Transwestern, "regardless of its need and regardless of the cost," 600,000 Mcf of gas per day. (SoCalGas Br. at 3). SoCalGas argues that, whether or not it needed such volumes of gas on a daily basis, it was still required to take such volumes.[5] (SoCalGas Br. at 3). It describes the Commission's Order No. 380 series as relieving it of "severe tariff restrictions" and argues that such orders allow SoCalGas "to purchase gas based upon relative cost rather than on these tariff provisions." (SoCalGas Br. at 3). Repeatedly, SoCalGas and the Commission refuse to address the fact that, with respect to Transwestern and other pipelines, the "tariff" provisions about which they complain are merely restatements of contracts between these companies and the pipelines which the Commission has reviewed and approved in Section 7 proceedings. The "severe tariff restrictions" to which SoCalGas refers are contract commitments which it voluntarily entered into, urged the Commission to approve in certificate proceedings, and operated under for many years. (TW Pet. A-1).

3. Reply to Reliance on *Permian*.

Both the Commission and SoCalGas place substantial reliance on this Court's decision in the *Permian Basin*

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[5] SoCalGas does not mention its contractual arrangements, nor does it mention its total market requirements, a relatively small portion of which is supplied by Transwestern.

Area Rate Cases, 390 U.S. 747 (1968). It was expressly recognized there, however, that the Natural Gas Act was premised on contractual arrangements devised by the regulated companies and that the Act contemplated abrogation of those agreements "only in circumstances of unequivocal public necessity." *Id.*, at 822. The decision notes that "[t]he Commission conducted extended hearings. . . ." *Id.*, at 755. Specifically, it stated that the hearings began on October 11, 1961 and closed in September, 1963, that the final transcript included more than 30,000 pages, that an examiner's decision was issued, and that the Commission heard three days of oral argument prior to issuing its decision on August 5, 1965. *Ibid.* In short, the procedures underlying Order No. 380 bear no resemblance whatsoever to the procedures followed in *Permian*.

4. Reply to Claim that Order No. 380 Does Not Affect Service Arrangements Certificated Under Section 7 of the Natural Gas Act.

While the Commission repeats its rationale that Order No. 380 deals solely with "rates," not terms and conditions of service (see Comm. Br. at 11), neither it nor SoCalGas address the unassailable fact that the minimum take provision in Transwestern's contract with SoCalGas fixed the character of service it contracted and was certificated to provide. The abrogation of such minimum take provision is swept along with the elimination of variable costs for minimum bills. It should be borne in mind that, both with respect to sales made under minimum bill provisions and those made pursuant to minimum take commitments, the rates which the pipelines can charge the distributor customers cannot exceed just and reasonable rates as fixed and provided by the Commission under Sections 4 and 5 of the Act. Thus, SoCalGas' comment that it would be required to take gas from Transwestern "regardless of the cost" (SoCalGas Br. at 3) is not correct. Its right to oppose any Trans-

western rate filing was fully preserved by contract. (TW Pet. A-4).

5. Reply to Claim that Contractual Minimum Bill and Minimum Take Provisions Are Appropriate for Generic Treatment.

The Commission challenges Transwestern's assertion that Order No. 380 involves "fact specific findings affecting a limited numbers of companies." (Comm. Br. at 22). Disregarding, *arguendo*, the difference between contractually based minimum bills and those incorporated in tariffs unilaterally through Section 4 filings, there is no basis for the contention that minimum take provisions involve "a general issue affecting all natural gas pipelines." Indeed, the Commission is careful not to assert such claim. (Comm. Br. at 22).[6] Under these circumstances, it can hardly be concluded that the requirements of *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519 (1978), have been satisfied in the informal rulemaking proceedings underlying Order No. 380. *See* 435 U.S. at 548.

CONCLUSION

Order No. 380 is based on the unprecedented theory that the industry will operate more efficiently if distributor customers have no obligation to purchase gas from their pipeline suppliers. It is significant that neither the Commission nor SoCalGas refers to any of the authorities which address the role of contracts under the Natural Gas Act. The essence of the controversy here is found in the Commission's statement,

> Petitioners' references (85-1219 Pet. 8-10) to the role of contracts under the Natural Gas Act are irrelevant.

(Comm. Br. at 15).

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[6] To Transwestern's knowledge, no more than four or five pipelines have such contract minimum take provisions.

Certiorari should issue to permit review of the decision of the court below.

Respectfully submitted,

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